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Supreme Court of the United States

October Term, 1994

PLUMBERS & STEAMFITTERS LOCAL 490 SEVERANCE AND RETIREMENT FUND; THE INDIVIDUAL PARTICIPANTS IN THE PLUMBERS & STEAMFITTERS LOCAL 490 SEVERANCE AND RETIREMENT FUND,

Petitioners,

vs.

WILLIAM APPLETON, TRUSTEE FOR THE LIQUIDATION OF FIRST OHIO SECURITIES COMPANY; SECURITIES INVESTOR PROTECTION CORPORATION,

Respondents.

Petition for Writ of Certiorari to the United States Court of Appeals for the Sixth Circuit

PETITION FOR WRIT OF CERTIORARI

RONALD G. MACALA
Counsel of Record
SHAWN C. GROFF
GREEN, HAINES, SGAMBATI,
MURPHY & MACALA CO., L.P.A.
Attorneys for Petitioners
4150 Belden Village Street
Suite 604
P.O. Box 35186
Canton, Ohio 44735
(216) 493-1570

QUESTIONS PRESENTED FOR REVIEW

1. Whether the Court of Appeals for the Sixth Circuit ("Sixth Circuit") erred in concluding that the Individual Participants of the Petitioner Plumbers and Steamfitters Local 490 Severance and Retirement Fund ("490 Fund") were not separate customers of the broker-dealer, First Ohio Securities Corp. ("FOSC") and, therefore, not entitled to payment or reimbursement under the Securities Investor Protection Act ("SIPA"), 15 U.S.C. § 78 aaa, *et seq.*, for losses resulting from the insolvency of FOSC.

2. Whether the Sixth Circuit erred in concluding that the claims filed by the Petitioners were "claims for cash" rather than "claims for securities" under SIPA.

3. Whether the Sixth Circuit erred in concluding that the Securities Investor Protection Act, 15 U.S.C. § 78 aaa, *et seq.*, does not protect the customers of an insolvent broker-dealer from fraud or breach of contract by the insolvent broker-dealer.

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The Petitioners, Plumbers & Steamfitters Local 490 Severance and Retirement Fund ("490 Fund") and the Individual Participants in the Plumbers & Steamfitters Local 490 Severance Fund ("Individual Participants"), respectfully pray that a writ of certiorari issue to review the judgment issued by the United States Court of Appeals for the Sixth Circuit filed on November 1, 1994, the judgment issued by the United States District Court for the Northern District of Ohio filed on February 8, 1993, and the judgment issued by the United States Bankruptcy Court for the Northern District of Ohio filed on December 31, 1991.

OPINIONS BELOW

There have been no official reports of the opinions rendered in this matter by the United States Bankruptcy Court for the Northern District of Ohio, the United States District Court for the Northern District of Ohio or the Court of Appeals for the Sixth Circuit. The judgment of the Sixth Circuit is, however, cited at 39 F.3d 1181 (6th Cir. 1994).

The Opinion and Judgment Entry of the United States Bankruptcy Court for the Northern District of Ohio, filed on December 23, 1991 is reproduced in the accompanying Appendix (App. C). The Opinion and Judgment Entry of the United States District Court for the Northern District of Ohio, filed on February 18, 1993, is reproduced in the accompanying Appendix (App. B). The Opinion and Order of the United States Court of Appeals for the Sixth Circuit, filed on November 1, 1994, is reproduced in the accompanying Appendix (App. A).

STATEMENT OF JURISDICTION

Jurisdiction over this action in the District Court existed pursuant to 28 U.S.C. § 157, §§ 158(a) and (b), and § 1334. This action arose under the Securities Investor Protection Act (SIPA), 15 U.S.C. § 78 aaa *et seq.*, and thus involved a federal question.

Appellate jurisdiction was vested in the Sixth Circuit under 28 U.S.C. § 158(d) and resulted from a final appealable order issued on February 18, 1993 by the Honorable Thomas D. Lambros, Chief Judge of the United States District Court for the Northern District of Ohio, Eastern Division. That decision resulted from an appeal taken by Petitioners in Case No. 590-0072 (SIPA) in the United States Bankruptcy Court for the Northern District of Ohio.

Jurisdiction over this matter is vested in the United States Supreme Court under 28 U.S.C. § 1254 to review the judgment issued on November 1, 1994 by the United States Court of Appeals for the Sixth Circuit.

STATUTES AND REGULATIONS INVOLVED

Statutes:

15 U.S.C.S. § 78aaa *et seq.*

This Act, with the following table of contents, is known as the "Securities Investor Protection Act of 1970".

15 U.S.C.S. § 78fff(c)

This statute defines customer status under SIPA. It reads in pertinent part as follows:

> **(c) Determination of customer status.** In a liquidation proceeding under this Act, whenever a person has acted with respect to cash or securities with the debtor after the filing date and in a manner which would have

> given him the status of a customer with respect to such cash or securities had the action occurred prior to the filing date, and the trustee is satisfied that such action was taken by the customer in good faith and prior to the appointment of the trustee, the date on which such action was taken shall be deemed to be the filing date for purposes of determining the net equity of such customer with respect to such cash or securities.

15 U.S.C.S. §78fff-2(d)

This statute is a portion of SIPA which directs how the SIPA trustee shall restore an aggrieved "customer" to the *status quo ante*. This statute reads in pertinent part as follows:

> **(d) Purchase of securities.** The trustee shall, to the extent that securities can be purchased in a fair and orderly market, purchase securities as necessary for the delivery of securities to customers in satisfaction of their claims for net equities based on securities under section 7(b)(1) [15 USCS § fff-1(b)(1)] and for the transfer of customer accounts under subsection (f), in order to restore the accounts of such customers as of the filing date. To the extent consistent with subsection (c), customer property and moneys advanced by SIPC may be used by the trustee to pay for securities so purchased. Moneys advanced by SIPC for each account of a separate customer may not be used to purchase securities to the extent that the aggregate value of such securities on

> the filing date exceeded the amount permitted to be advanced by SIPC under the provisions of section 9(a) [15 USCS § fff-3(a)].

15 U.S.C.S. § 78lll(2)

This statute defines a "customer" under SIPA. It reads in pertinent part as follows:

> **(2) Customer.** The term "customer" of a debtor means any person (including any person with whom the debtor deals as principal or agent) who has a claim on account of securities received, acquired, or held by the debtor in the ordinary course of its business as a broker or dealer from or for the securities accounts of such person for safekeeping, with a view to sale, to cover consummated sales, pursuant to purchases, as collateral security, or for purposes of effecting transfer. The term "customer" includes any person who has a claim against the debtor arising out of sales or conversions of such securities, and any person who has deposited cash with the debtor for the purpose of purchasing securities, but does not include —
>
> (A) any person to the extent that the claim of such person arises out of transactions with a foreign subsidiary of a member of SIPC; or
>
> (B) any person to the extent that such person has a claim for cash or securities which by contract, agreement, or understanding, or by

> operation of law, is part of the capital of the debtor, or is subordinated to the claims of any or all creditors of the debtor, notwithstanding that some ground exists for declaring such contract, agreement, or understanding void or voidable in a suit between the claimant and the debtor.

15 U.S.C.S. § 78lll(14)

This statute defines "security" under SIPA. It reads in pertinent part as follows:

> The term "security" means any note, stock, treasury stock, bond, debenture, evidence of indebtedness, any collateral trust certificate, preorganization certificate or subscription, transferable share, voting trust certificate, *certificate of deposit*, certificate of deposit for a security, any investment contract or certificate of interest or participation in any profit-sharing agreement or in any oil, gas, or mineral royalty or lease (if such investment contract or interest is the subject of a registration statement with the Commission pursuant to the provisions of the Securities Act of 1933), any put, call, straddle, option, or privilege entered into on a national securities exchange, relating to foreign currency, any certificate of interest or participation in, temporary or interim certificate for, *receipt for, guarantee of*, or warrant or right to subscribe to or purchase or sell *any of the foregoing*, and any other instrument commonly known as a security. Except as

> specifically provided above, the term "security" does not include any currency, or any commodity or related contract or futures contract, or any warrant or right to subscribe to or purchase or sell any of the foregoing. (Emphasis added).

ERISA § 2 (34), 29 U.S.C. § 1002(34)

This provision in the Employee Retirement Income Security Act defines a "defined contribution plan." It reads in pertinent part as follows:

> The term "individual account plan" or "defined contribution plan" means a pension plan which provides for an individual account for each participant and for benefits based solely upon the amount contributed to the participant's account, and any income, expenses, gains, and losses, and any forfeitures of account of other participants' which may be allocated to such participants account.

IRC § 414(h)(2)(i), 26 U.S.C. § 414(i)

This provision of the Internal Revenue Code defines a "defined contribution plan." It reads in pertinent part as follows:

> *Defined Contribution Plan.* For purposes of this part, the term "defined contribution plan" means a plan which provides for an individual account for each participant and for benefits based solely on the amount contributed to the participant's account, and any income, expenses, gains and losses, and

any forfeitures of accounts of other participants which may be allocated to such participant's account.

Regulations:

These regulations were enacted pursuant to SIPA and define whether a customer has a "claim for cash" or a "claim for securities". These regulations, known as part of the Series 500 Regulations, read in pertinent part as follows:

17 C.F.R. § 300.500. General.

These rules will be applied in determining whether a securities transaction gives rise to a "claim for cash" or a "claim for securities" on the filing date of either a liquidation proceeding pursuant to the Securities Investor Protection Act (hereinafter referred to as "the Act") or a direct payment procedure pursuant to section 10 of the Act.

17 C.F.R. § 300.502. Claim for securities.

(a) Where the Debtor held cash in an account for a customer, the customer has a "claim for securities" with respect to any authorized securities purchase:

(1) If the Debtor has sent a written confirmation to the customer that the securities in question have been purchased for or sold to the customer's account; or

(2) Whether or not such a written

confirmation has been sent, if the securities in question have become the subject of completed or executory contract for sale for or purchase from the account.

(b) Where the Debtor held securities in an account for a customer, the customer has a "claim for securities", notwithstanding the fact that the customer has ordered the securities sold for the account, unless:

(1) The Debtor has sent written confirmation to the customer that the securities in question have been sold for or purchased from the customer's account; or

(2) Whether or not written confirmation of the purchase has been sent, if the securities in question have become the subject of completed or executory contract for sale for or purchase from the account.

STATEMENT OF THE CASE

A. Proceedings Below

On June 10, 1990, the Plumbers and Steamfitters Local No. 490 Severance and Retirement Fund ("490 Fund") filed a Complaint in the United States District Court for the Northern District of Ohio, Eastern Division. The Complaint was given Case No. 5:90-CV-1057 and assigned to the Honorable David Dowd, Jr. Named as defendants in the Complaint were First Ohio Securities Corporation (FOSC) and its principal officer, Thomas Gilmartin. The Complaint alleged that FOSC and Gilmartin fraudulently converted securities that had been transferred by the 490 Fund to FOSC and Gilmartin for investment purposes.

On June 22, 1990, the Securities Investor Protection Corporation ("SIPC") filed an action in the United States District Court for the Northern District of Ohio, Eastern Division, under the Securities Investor Protection Act ("SIPA"). The SIPC litigation named FOSC as it principal defendant. In that litigation, SIPC sought to enjoin the further prosecution of any claims by the 490 Fund against FOSC and it sought the appointment of a Trustee to liquidate FOSC. In the United States District Court, this litigation was known as *Securities Investor Protection Corporation v. First Ohio Securities Co.*, Case No. 5:90-CV-1125.

Judge Dowd granted the preliminary relief sought by SIPC and authorized the removal of the case to the United States Bankruptcy Court for the Northern District of Ohio (App. E). In Bankruptcy Court, the litigation was styled as a Chapter 7 liquidation proceeding and was known as *In re: First Ohio Securities Corporation*, Case No. 590-0072 (SIPA) (hereinafter generally referred to as the "litigation").

On July 30, 1990, the Trustee notified customers and creditors of FOSC of the liquidation and issued instructions regarding the claims filing process. As a result, the 490 Fund, in its own name and on behalf of its participants, filed the following claims:

Plumbers and Steamfitters Local No. 490 Severance and Retirement Fund as a security claim for CD's	$1,344,220.21
Cash Claim	$ 103,810.11
Individual Participants in the 490 Fund duplicate of 490 Fund claim	$1,448,030.32

On February 5, 1991 the Trustee made a payment to the 490 Fund in the amount of One Hundred Thousand Dollars

($100,000). The Trustee determined that the claims by the 490 Fund and its Participants were for cash only since the securities claimed to have been lost by the Fund allegedly never existed. Subsequently, on March 1, 1991, the 490 Fund and its Participants filed written objections to the Trustee's determination.

On May 9, 1991, May 30, 1991, and May 31, 1991, hearings on Petitioners' objection were held before the Honorable Harold F. White, United States Bankruptcy Court for the Northern District of Ohio. On December 23, 1991, Judge White issued an Order upholding the Trustee's determination that only the 490 Fund was a customer of FOSC and was entitled to assert a "claim for cash." The Bankruptcy Court ruled that the Individual Participants of the 490 Fund were not "customers" of FOSC as defined by SIPA (App. C).

On December 31, 1991 the 490 Fund, and its participants, filed with the Clerk of the United States Bankruptcy Court for the Northern District of Ohio their Notice of Appeal from Judge White's December 23, 1991 Order and Findings. On February 21, 1992 the record in this case was transferred to the Clerk for the United States District Court for the Northern District of Ohio and assigned to Chief Judge Thomas Lambros as Case No. 5:92-CV-0349.

On February 4, 1993, Judge Lambros heard oral arguments on the appeal filed by the 490 Fund and its Participants. On February 18, 1993, Judge Lambros issued an Order affirming the Bankruptcy Court's decision (App. B). On March 16, 1993 a Notice of Appeal to the Sixth Circuit was filed, by the 490 Fund and the Individual Participants of 490 Fund, from the decision of Judge Lambros.

On May 2, 1994 oral arguments were held in the Sixth Circuit on Petitioners' appeal. Judge Martin, Judge Norris and Judge Daughtrey comprised the Sixth Circuit panel which heard

Petitioners' appeal. On November 1, 1994 the Sixth Circuit issued an Entry affirming the February 18, 1993 decision of the District Court.

B. Statement of the Facts

The 490 Fund is a multi-employer Taft-Hartley trust fund established pursuant to 29 U.S.C. § 186(c)(5). The Fund is managed by three Trustees appointed by Plumbers Local Union 490 and three Trustees appointed by contractors that have collective bargaining relationships with Local 490. The Fund is designed to provide supplemental retirement and severance pay benefits to members of Local 490.

The 490 Fund is a "defined contribution" pension plan. Unlike a "defined benefit" pension plan (which provides a specific benefit to participants based upon years of service and compensation), the participants in a defined contribution plan have separate accounts within the plan. Fixed employer contributions are made to the plan for each hour that a participant works for a signatory contractor and those contributions are allocated to a participant's individual account. A participant in a defined contribution plan is vested immediately in the contributions that are allocated to his individual account. At any given point in time, a participant's interest in his account can be determined in the following manner:

> Dollar amount of contributions made on behalf of the participant.
>
> \+ Gain (Loss) on investments during the period examined.
>
> \- Administrative expenses
>
> ---
>
> = Net value of participant's account in the defined contribution plan.

Such is the case with the 490 Fund. When contributions were made on behalf of participants in the 490 Fund, those contributions were allocated to individual accounts established for each member. Although the contributions would be invested by the 490 Fund in lump sums, the return on those investments would be allocated to each participant in accordance with the percentage share that each participant had in the Fund. A participant was annually advised by the Fund of the value of his individual account, after the Fund allocated to those accounts the gains realized in investments and subtracted the administrative expense involved in operating the Fund.

During the relevant periods in question, the Administrator and Consultants for the 490 Fund were First Benefits Agency, Inc., ("FBA") and its principal officer, Robert Frazier. Throughout its existence, the 490 Fund has been managed in a conservative fashion. For the most part, assets of the Fund were invested in certificates of deposits. In early 1989, Frazier advised the Trustees of the 490 Fund that he had become aware of a program that involved "pooled certificates of deposit." The program was being offered by Thomas Gilmartin, through his investment company, FOSC. Frazier represented to the Fund that he was knowledgeable of the investment expertise of FOSC and Gilmartin and that he felt the 490 Fund should seriously consider transferring most of its fixed-income assets to FOSC and Gilmartin for investment purposes.

Frazier spoke with Gilmartin prior to any asset transfer by the 490 Fund and confirmed that Gilmartin was appropriately insured through the Securities Investor Protection Corporation (SIPC) and that each participant's individual account would receive the same SIPC insurance protection as the Fund would receive.

In the Summer of 1989, the Trustees of the 490 Fund

accepted Frazier's recommendation. The Fund liquidated One Million Three Hundred Forty-Four Thousand Two Hundred Twenty Dollars and twenty-one cents ($1,344,220.21) in securities and transferred that sum, along with an additional Two Hundred and Thirty-Four Thousand Dollars ($234,000) in cash, to FOSC and Gilmartin. FOSC acknowledged receipt of these assets by furnishing confirmation statements to Frazier and FBA through FOSC's custodian, Financial Clearing and Services Corporation.

The 490 Fund directed FOSC to purchase "pooled certificates of deposit" with the transferred assets. For the next several months, FOSC notified the Fund, in writing, that purchases of "pooled certificates of deposit" had been made on behalf of the Fund.

In late 1989, FBA and Frazier requested that they be relieved of the administrative responsibilities for the 490 Fund. The Trustees honored Frazier's request and engaged S.R. Snodgrass Company ("Snodgrass") as Administrator. Snodgrass continued to receive confirmation documents from FOSC showing that certificates of deposits had been, and were being, purchased by FOSC for the Fund. However, in November 1989, Snodgrass detected what appeared to be irregularities in some of the confirmation documents being supplied by FOSC. Snodgrass brought this to the attention of the Chairman of the Board of Trustees, and then to Frazier and FBA, who remained with the Fund as Consultants.

Several attempts were made by Frazier and Snodgrass to extract additional confirmation from FOSC and Gilmartin that the assets of the Fund were being appropriately utilized to purchase certificates of deposit for Fund participants. Meetings were held in early 1990 between the Trustees and Gilmartin. On at least two occasions, Gilmartin would not respond to inquiries

from the Trustees regarding his investment activity on behalf of the Fund. Neither would he confirm the precise amount that was being invested by FOSC on behalf of the Fund. As a result, the Trustees instructed Frazier and FBA, in their capacities as Consultants to the Fund, to advise FOSC and Gilmartin that the Fund was immediately terminating its relationship with them. The Trustees also instructed Frazier to direct FOSC to immediately return all assets that it held on behalf of Fund participants to the Fund.

Since the Trustees of the Fund received no response from FOSC and Gilmartin regarding their demands, the litigation which gave rise to this appeal was initiated. During that litigation, it was established that FOSC and Gilmartin fraudulently converted the assets which had been transferred to them by the 490 Fund for investment purposes. FOSC and Gilmartin apparently had contrived and elaborate "Ponzi" scheme whereby they would, through fraud and misrepresentation, obtain and acquire assets from investors. With these assets, they would partially pay other defrauded investors and retain substantial portions of the unlawfully acquired assets for their own use.

FOSC and Gilmartin consistently and repeatedly provided written confirmations to the 490 Fund, and its Participants, that securities were, in fact, being purchased for them. The 490 Fund, and its Participants, could not confirm that these representations were false until this litigation was initiated.

As a result of the litigation and the claim filed by the 490 Fund, the 490 Fund has received a payment from the SIPC Trustee in the amount of $100,000. Under SIPA, a SIPC trustee is empowered to pay customers who have suffered losses as a result of broker insolvency to the extent of $100,000 if the customer has a claim for "cash"; or, to the extent of $500,000 if the customer has a claim for "securities". Since the SIPC Trustee determined

that the Individual Participants of the 490 Fund were not entitled to "customer" status under SIPA, and since the Trustee determined that the 490 Fund had a "customer" claim for cash only, the $100,000 payment to the 490 Fund was made. The total loss suffered by the 490 Fund, and its Participants, was almost $1.4 million dollars.

Had the Trustee determined that the Individual Participants of the 490 Fund each were entitled to "customer" status under SIPA, the 490 Fund, and its Participants, would have been made whole for the entire loss that was suffered at the hands of FOSC and Gilmartin. Alternatively, had the Trustee determined that the claim here was a claim for "securities" as opposed to a claim for "cash", the recovery by the 490 Fund would have been five (5) times greater and would substantially have reduced the loss of the 490 Fund, even if customer status were not extended to its Individual Participants.

REASONS FOR GRANTING THE WRIT

This case raises significant legal issues which have not been addressed or decided by this Court. And, it involves issues over which the Federal Circuit Courts of Appeal, the District Courts and the Bankruptcy Courts are in conflict.

The Sixth Circuit specifically determined that the Individual Participants of the 490 Fund were not "customers" as that term is defined by 15 U.S.C. § 78 lll(2) (App. 3a). This decision was based upon an inapposite decision from the United States Court of Appeals for the Second Circuit, *SIPC v. Morgan Kennedy*, 533 F.2d 1314 (2nd Cir. 1976), *cert. den. sub nom., Trustees of Reading Body Works, Inc. v. SIPC*, 426 U.S. 936 (1976). The Second Circuit decision negates the right of individual participants in a defined contribution plan to achieve "customer" status under SIPA. This issue has never been addressed by this Court.

The Sixth Circuit also erroneously determined that the claims of the 490 Fund and its Individual Participants were claims for "cash" and not claims for "securities." (App. 3a). That determination is in direct contravention of SIPA, specifically 15 U.S.C. § 78 lll(14), as well as applicable SIPA and SEC regulations. This issue constitutes a significant federal law question which has not yet been addressed by this Court.

The Sixth Circuit erroneously concluded that SIPA's sole purpose is to protect investors against a broker-dealer's insolvency, not to protect investors from a broker-dealer's fraud (App. 3a). This decision is not based upon any applicable Sixth Circuit law and directly contravenes the legislative history underlying SIPA. This conclusion by the Sixth Circuit involves a federal law question of great importance which has yet to be decided by this Court. It also creates a conflict between the Sixth Circuit and Ninth Circuit Court of Appeals. *See, SIPC v. Vigman*, 803 F.2d 1513 (9th Cir. 1986), *appeal after remand*, 908 F.2d 1461 (9th Cir. 1990), *aff'd in part and rev'd in part on other grounds*, __ U.S __, 112 S. Ct. 1311, 117 L. Ed. 2d 532 (1992).

A review of the SIPA issues raised by this Appeal is imperative. As is evident from the recent savings and loan travesties, as well as the recent Orange County, California, debacle, claims by investors against broker-dealers are not only prevalent, they are widespread and continuing. Without question, many of these claims will evolve into claims under SIPA. SIPA was enacted to restore investor confidence in the securities market and to secure the financial responsibility of broker-dealers. This Court has a rare opportunity to review significant SIPA issues and to provide guidance to all institutional investors, such as employee benefit plans, that presently are covered by SIPA or that may become involved in litigation under SIPA in the future.

I. THE SIXTH CIRCUIT ERRED IN CONCLUDING THAT THE INDIVIDUAL PARTICIPANTS OF THE 490 FUND WERE NOT SEPARATE CUSTOMERS OF THE BROKER-DEALER, ("FOSC") AND, THEREFORE, NOT ENTITLED TO PAYMENT OR REIMBURSEMENT UNDER THE SECURITIES INVESTOR PROTECTION ACT ("SIPA").

One of the primary contentions of the 490 Fund is that the Fund, and its Individual Participants, should each be considered "customers" under SIPA and, therefore, eligible to receive an appropriate amount of cash or equivalent securities as a result of the fraudulent conversion of assets by FOSC. There is sound and compelling legal basis for this proposition.

The 490 Fund is a multi-employer "Taft-Hartley" trust fund established under 29 U.S.C. § 186(c)(5). These Funds are jointly managed by equal numbers of Trustees appointed by labor and management. The 490 Fund is a "defined contribution" pension plan. This fact is critical in assessing the claims of the 490 Fund and its participants.

As an employee benefit plan, the 490 Fund is subject to regulation by the Employee Retirement Income Security Act (ERISA), 29 U.S.C. § 1001 *et seq.* and the Internal Revenue Code (IRC). Each of these legislative enactments address and regulate the operation of defined contribution plans.[1]

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1. Under ERISA § 2(34), a defined contribution plan means:

> . . . A pension plan which provides for an individual account for each participant and for benefits based solely upon the amount contributed to the participant's account, and any income, expenses,

(Cont'd)

The 490 Fund, although generally referred to as a pension plan, is a trust that is comprised exclusively of individual, distinct and segregated participant accounts. When a participant renders services to an employer who is signatory to an appropriate collective bargaining agreement, contributions are made by the employer to that participant's account for each hour worked. The participant is immediately vested in the sums that are allocated to his account. The net value of the participant's account is determined by computing the dollar amount of contributions to the account, then allocating to each participant account the investment income generated by the Fund, and subtracting from that total the participant's pro-rata share of the administrative expenses of the Fund. The 490 Fund, accordingly, has a combined value equal to the value of each Individual Participant's account.[2]

At the time the 490 Fund elected to transfer assets to FOSC for purposes of investment, each of the Participants in the 490

(Cont'd)

> gains, and losses, and any forfeitures of account of other participants which may be allocated to such participants account.

See also, IRC § 414(h)(2)(i).

2. A defined contribution plan (such as the 490 Fund) is the opposite of a defined benefit plan. Under a defined benefit plan, a participant does not have an individual account in the trust fund. The participant's interest in the defined benefit plan usually does not vest until the participant earns a specified amount of service credit under the plan. Finally, under a defined benefit plan, the participant receives a benefit that is not related directly to the amount of contributions that have been made on his behalf to the plan. Rather, the benefit is based upon the participant's age, years of service and final compensation at the point of retirement. *See*, IRC § 414(h)(2)(j); ERISA § 2(35).

Fund had a definable percentage interest in those assets.[3] Individual claims were filed with SIPC on behalf of each Individual Participant in the 490 Fund, as well as the Fund itself. The 490 Fund urged that it, and each of its Participants, be considered "customers" for purposes of these SIPA proceedings.

This contention by the 490 Fund finds support in the statutory language of SIPA and decisional law. For example, 15 U.S.C. § 78 lll(2), provides, in pertinent part, that:

> The term "customer" includes any person who has a claim against the debtor arising out of securities, *and any person who has deposited cash with the debtor for the purpose of purchasing securities*, . . .

(emphasis supplied).

Without question, each of the Individual Participants in the 490 Fund "deposited cash" with FOSC for the purposes of purchasing certificates of deposits. Accordingly, the 490 Fund, and its Individual Participants, should be deemed "customers" for purposes of these proceedings.

Moreover, bankruptcy courts have recognized that individual participants in a defined contribution plan (such as the 490 Fund) attain "customer" status under SIPA as long as fund assets actually are transferred to a broker-dealer. *See, In re*

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3. If gains were realized through those investments, each participant would have received a proportionate share of those gains, a share commensurate with the percentage that each participant had in the Fund as a whole. Conversely, any losses suffered by the 490 Fund would be allocated to each participant. The loss would be allocated on the same percentage basis that each participant had in the Fund.

Waddell Jenmar Securities, Inc., 126 B.R. 935, 940 (Bkrtcy. E.D.N.C. 1991), *aff'd*, 991 F.2d 792 (4th Cir. 1993). That is precisely the situation here.[4]

The Sixth Circuit relied solely upon *SIPC v. Morgan, Kennedy & Co.*, 533 F.2d 1314, 1317-21 (2d Cir. 1976) for its conclusion that the Individual Participants in the 490 Fund were not "customers" under SIPA. *Morgan* was decided by the Second Circuit in 1976 and is premised upon facts which arose prior to the enactment of ERISA. *Morgan* has never been specifically followed by the Sixth Circuit or any other federal court of appeals with respect to this issue. Indeed, *Morgan* conflicts with a much more recent decision, *Waddell, supra*, which clearly supports the position being advanced by Petitioners.

Morgan misreads and misapplies SIPA principles. SIPA was enacted to preserve the claims of individual customers who had been harmed by broker-dealer insolvencies. In *Morgan*, the participants in the profit-sharing plan therein had no vested interest in that plan until their employment was terminated. In this case, however, the Individual Participants in the 490 Fund were 100% vested in their individual accounts at all times. Thus, unlike the employees in *Morgan*, their status as Individual

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4. As customers under SIPA, the Individual Participants in the 490 Fund should be treated as either having claims for cash or claims for securities. *See*, 15 U.S.C. § 78 fff and 17 C.F.R. §§ 300.500 - 300.502. If these participants are deemed to have claims for cash, each participant is eligible to present a claim of up to One Hundred Thousand Dollars ($100,000) to SIPC. Since no Individual Participant had an account balance that exceeded One Hundred Thousand Dollars ($100,000), these claims would be appropriate and allowable. Alternatively, SIPC could purchase for each Individual 490 Fund Participant a certificate of deposit that approximated the value of each participant's account. Again, since no participant account exceeded One Hundred Thousand Dollars ($100,000), this purchase by SIPC would be appropriate and allowable under SIPA.

Participants, and thus as customers, should not have been questioned. Finally, *Morgan* ignores the present critical difference between a defined contribution plan and defined benefit plan, a distinction that did not legislatively exist at the time the profit-sharing plan in *Morgan* was established. Those important ERISA and IRC principals which establish and distinguish defined contribution plans are, in effect, extinguished through the application of the stale *Morgan* decision.

Given the number of broker-dealer insolvencies, as well as other instances of broker-dealer misconduct, it legitimately can be expected that participants in defined contribution plans will be relying extensively on SIPA for protection and reimbursement for losses. There is no pronouncement from this Court as to whether the participants in a defined contribution plan under ERISA are entitled to "customer" status under SIPA. This issue, as is so painfully evident in this case, is extremely significant. It may mean the difference between an employee benefit plan receiving full reimbursement under SIPA and very little reimbursement. Since SIPA is a remedial statute, designed to protect individual investors and to foster confidence in the investment industry, a meaningful examination and resolution of this issue by this Court is needed.

II. THE SIXTH CIRCUIT ERRED IN CONCLUDING THAT THE CLAIMS FILED BY PETITIONERS WERE CLAIMS FOR "CASH" RATHER THAN CLAIMS FOR "SECURITIES".

The Sixth Circuit's decision that the Petitioners' SIPA claims were claims for "cash" rather than "securities" contravenes the current provisions of SIPA, the SEC Series 500 regulations governing the operation of SIPC and the relevant provisions of the Bankruptcy Code.

The claims of the 490 Fund, and its Individual Participants, are premised on the fact that the certificates of deposit which FOSC was instructed to purchase for them were "securities" under SIPA. *See*, 15 U.S.C. § 78 lll (14).[5] Since the 490 Fund and its Individual Participants expected that they were purchasing "certificates of deposit," and had that expectation confirmed by FOSC, they met the literal requirements for claiming a "security" under 15 U.S.C. § 78 lll (14).

Petitioners have produced ample evidence to establish that they intended to, and believed they had purchased securities; and that on the filing date, the debtor, FOSC, held those securities for

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5. 15 U.S.C. § 78 lll(14) defines the term "security" as follows:

> The term "*security*" means any note, stock treasury stock, bond, debenture, evidence of indebtedness, any collateral trust certificate, preorganization certificate or subscription, transferable share, voting trust certificate, *certificate of deposit*, certificate of deposit for a security, any investment contract or certificate of interest or participation in any profit-sharing agreement or in any oil, gas, or mineral royalty or lease (if such investment contract or interest is the subject of a registration statement with the Commission pursuant to the provisions of the Securities Act of 1933), any put, call, straddle, option, or privilege entered into on a national securities exchange, relating to foreign currency, any certificate of interest or participation in, temporary or interim certificate for, *receipt for, guarantee of*, or warrant or right to subscribe to or purchase or sell *any of the foregoing*, and any other instrument commonly known as security. Except as specifically provided above, the term "security" does not include any currency, or any commodity or related contract or future contract, or any warrant or right to subscribe to or purchase or sell any of the foregoing. (emphasis added).

the 490 Fund and its Participants. The evidence that the 490 Fund presented at the May, 1991 Bankruptcy hearings to support the existence of securities, or "customer name securities," *see* 15 U.S.C. § 78 lll(3), included written *confirmations* from the Financial Clearing and Services Corporation to the 490 Fund and specific account statements provided to the 490 Fund by FOSC. All of these documents reflect and indicate that certificates of deposit were actually purchased by FOSC on behalf of the 490 Fund and its participants.

That Petitioners have a claim for securities is further supported by the regulations of the Securities and Exchange Commission, 17 C.F.R. Ch. 11, Part 300, April 1, 1992 Ed. Part 300.502 very plainly recites that:

> 17 C.F.R. *300.502 Claim for securities.*
>
> (a) Where the Debtor held cash in an account for a customer, the customer has a "*claim for securities*" with respect to any authorized securities purchase:
>
> (1) *If the Debtor has sent a written confirmation to the customer that the securities in question have been purchased for or sold to the customer's account;* or

The regulations cited, *supra*, establish that the 490 Fund, and its Individual Participants, have a "claim for securities" since FOSC and/or its agent sent written *confirmations* to the 490 Fund that certificates of deposit had been purchased by FOSC for their account(s).[6]

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6. At the time in which extensive amendments were made to SIPA, the then-Commissioner of the SEC., Philip A. Loomis, commented in hearings concerning those amendments that "When a customer sells securities, his (Cont'd)

In the present case, the Petitioners' *legitimate expectations* were that their accounts held securities as of the filing date. Under the facts presented, the statutory scheme requires a finding that the Petitioner 490 Fund, and its Individual Participants, are entitled to assert a claim for securities under SIPA.

There is judicial support for Petitioners' claim that SIPA does not require that securities actually exist prior to the filing date in order for a customer to have a legitimate "claim for security." *See In Re: June S. Jones Co.*, 52 B. R. 810 (Bank. D. Ore. 1985). In *Jones*, the Bankruptcy Court held that § 78 fff-2(d) eliminates any requirement that securities actually be purchased prior to the filing date, if the customer *expected* the securities to be purchased. According to the Court, the legislative history of §78 fff-2(d) very clearly establishes that a security need not actually exist in order for a customer to have a claim for security. The Court stated:

> Under present law, because securities belonging to customers may have been lost, improperly hypothecated, misappropriated, *never purchased* or even stolen, it is not always possible to provide to customers that

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(Cont'd)
claim from that time until settlement and delivery of the funds is a claim for cash." *Id.* at 815, *citing, Hearing Before Subcommittee on Consumer Protection and Finance of the Committee on Interstate and Foreign Commerce*, 95th Cong., 1st Sess. 233 (1977). Such a comment that a customer, once he offers a security for sale, expects to receive cash for the sale of the security. It would also be true that, if a customer maintains a security in his account, he will continue to have a legitimate expectation that he either has a security or will have a "claim for security" in the event of a liquidation. It is clear from a reading of the SIPA rules and regulations, and the comments concerning the purpose and intent of the rules, that SIPA was designed to protect the *legitimate expectations* of customers of SIPC members.

> which they expect to receive, that is, securities which they maintained in their brokerage account. Instead, when the customer claims for a security exceed the supply available to the Trustee in the debtors estate, then customers generally receive pro-rata portions of the securities claims; as to any remainder, they receive cash based on the market value as of the filing date (normally the date the liquidation proceeding is initiated).
>
> The principle underlying the purpose of the bill is to permit a customer to receive securities to the maximum extent possible instead of cash, in satisfaction of a claim for securities. By seeking to make customer accounts whole and returning them to customers in the form they existed on the filing date, the amendments not only would satisfy the customer's *legitimate expectations*, but also would restore the customer to his position prior to the broker-dealer's financial difficulties.

Jones, 52 B.R. at 814, S. Rep. No. 763, 95th Cong., 2d Sess. 2 (1978), *reprinted in*, 3 U.S. Code Cong. & Admin. News, 764, 765 (Emphasis added). *See also*, *In re C.J. Wright & Company, Inc.*, 162 B.R. 597 (M.D. Fla. 1993).

As the evidence in this case shows, the 490 Fund received purchase confirmations and account statements from FOSC establishing that certificates of deposit had been purchased by FOSC for the 490 Fund. The 490 Fund, and its Participants, legitimately expected those securities to be in existence on the

date of filing. The fact that those securities may not have existed on the date of filing does not diminish that expectation. Under SIPA §78 fff-2(d), and 17 C.F.R. Ch.11 Part 300 (1992), the 490 Fund and its participants had a *legitimate* "claim for securities". This Court has never addressed this "cash" versus "securities" issue under SIPA. As with the "individual customer" issue presented *supra*, the resolution of this second issue is critical: it may mean the difference between a $100,000 reimbursement and a $500,000 reimbursement to a defrauded customer under SIPA. In its decision the Sixth Circuit cited no authority for its ruling that the Petitioners have a "claim for cash" rather than a "claim for securities." This Court must provide some guidance on this critical issue.

III. THE SIXTH CIRCUIT ERRED IN CONCLUDING THAT SIPA DOES NOT PROTECT CUSTOMERS FROM FRAUD OR BREACH OF CONTRACT BY AN INSOLVENT BROKER-DEALER.

The Sixth Circuit affirmed the holdings of the District Court and the Bankruptcy Court that the presence of fraud in this case disqualifies the Petitioners from the protections accorded by SIPA, through SIPC, for customers with claims for securities. This judicial determination that fraud defeats a claim for securities under SIPA is legally incorrect and should be reversed.

If the rationale of the Sixth Circuit and the lower courts is accepted, no claimant would ever have a valid claim for securities under SIPA if the losses suffered by the claimant could be related, in some way, to fraudulent conduct. Neither SIPA, nor its corresponding regulations, specifically prohibit the payment of claims for either cash or *securities*, due to losses occasioned by fraud. In fact, the legislative history of SIPA strongly encourages the conclusion that fraudulent conduct gives rise to a legitimate claim under SIPA.

The legislative history of SIPA reveals that its purpose is to protect customers of brokerage houses, to restore investor confidence in the securities market and to upgrade the financial responsibility of broker-dealers. *See, e.g. S.E.C. v. White & Co., Inc.*, 547 F.2d 789, 791 (8th Cir. 1976). The statutory scheme of SIPA:

> expresses *unequivocal* Congressional intent to protect the public. Even though SIPC, unlike FSLIC, RTC, or FDIC, is not a governmental agency, it was, nevertheless, created by Congress for the purpose of protecting members of the public who invest in securities, and thereby enhancing and improving the commercial life of the nation.

In Re: Donald Sheldon & Co., Inc., 153 B.R. 661 (Bkrtcy. S.D.N.Y. 1993).[7]

Congress, in enacting SIPA to arrest the collapse of brokerage firms, and restore investor confidence in the capital markets, was meticulous in defining those circumstances which

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7. *See also, In Re: Brittenum and Associates, Inc.*, 82 B.R. 64 (Bkrtcy. E.D. Ark. 1987), *aff'd*, 868 F.2d 272 (8th Cir. 1989), *citing In Re: Hanover Square Securities*, 55 B.R. 235 (Bkrtcy S.D.N.Y. 1985). *See also, In Re: Stalvey and Associates*, 750 F.2d 464 (5th Cir. 1985) and *In Re: John Muir and Co.*, 51 B.R. 150 (Bkrtcy S.D.N.Y. 1985).

This matter was also addressed by the court in *Wright, supra*. In *Wright* the bankruptcy court held that SIPA provides customer status for claims based on misappropriation and unauthorized purchases. *In re C.J. Wright, supra* at 607 *citing, SEC v. S.J. Salmon & Co.*, 375 F.Supp. 867 (S.D.N.Y. 1974); *SEC v. Howard Lawrence & Co.*, 1 Bankr. Ct. Dec. 577 (Bankr. S.D.N.Y. 1975) and *In the Matter of Investors Sec. Corp.*, 6 B.R. 420 (Bankr. W.D. Pa. 1981). The *Wright* court held that SIPA covers cases where the debtor/broker used claimants' funds for an unauthorized transaction. *Wright, supra* at 608. Thus, *Wright* clearly supports the proposition that SIPA was designed to cover fraud.

would not warrant the payment of a claim by SIPC. *See* S. Rep. No. 91-1218, pp. 2-4 (1970); H.R. Rep. No. 91-16513, p. 264 (1970). Nowhere are losses resulting from fraud identified as ineligible claims. Consequently, it is logical to assume that, if fraud were a legitimate basis for denying a claim, Congress would have so stated in SIPA. This is not the case.[8]

In the case *sub judice*, the Trustee and the lower courts have pointed to the fraud of FOSC and Gilmartin as a basis for denying the claims of the 490 Fund and its Individual Participants. This contention, in light of the referenced legislative history of SIPA, is without basis. If a SIPA Trustee is required to either purchase a security or grant a customer's claim for a security in those situations where the customer's security has been misappropriated, stolen or *never purchased*, there is no legitimate reason to deny a customer's claim for a security because the loss resulted from fraud. If a security is misappropriated, or lost through fraudulent conduct, the result should be the same for the customer under SIPA. *See Vigman, supra*, and 15 U.S.C. § 78 fff-2(d).[9]

This Court has never addressed the issue of whether SIPA's protection extends to investors who have been damaged as a result of a broker-dealer's fraud.[10] The Sixth Circuit's conclusion

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8. Since SIPA's enactment in 1970, Congress has had ample opportunity to amend SIPA to prohibit customer claims resulting from fraud. This has not occurred. Therefore, fraud should not disqualify an otherwise valid SIPA claim.

9. *See also, Matter of Investors Sec. Corp.*, 6 B.R. 420 (W.D. Pa. 1980). The court in *Investors* held that, "It would strike at the core of customer protection to hold that the misuse by the Debtor's agents of monies entrusted to it by its customers defeats customer recovery under the SIPA." *Investors*, 6 B.R. at 426.

10. The decision by the Sixth Circuit in this case is in conflict with *Vigman, supra*, and makes review by this Court even more important.

on that point is at odds with the provisions of SIPA and its legislative history. A review and determination by this Court is necessary so that investors, nationwide, may determine with certainty whether their investments are adequately protected by SIPA and SIPC in situations like the case *sub judice*.

CONCLUSION

For these reasons, and based upon the law set forth above, the Plumbers and Steamfitters Local 490 Severance and Retirement Fund and its Individual Participants respectfully request that this Court accept jurisdiction over this appeal and grant the requested petition.

Respectfully submitted,

RONALD G. MACALA
Counsel of Record
SHAWN C. GROFF
GREEN, HAINES, SGAMBATI,
MURPHY & MACALA CO., L.P.A.
Attorneys for Petitioners
4150 Belden Village Street
Suite 604
P.O. Box 35186
Canton, Ohio 44735
(216) 493-1570

APPENDIX A — DECISION FROM THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT FILED NOVEMBER 1, 1994

NOT RECOMMENDED FOR PUBLICATION

No. 93-3313

UNITED STATES COURT OF APPEALS
FOR THE SIXTH CIRCUIT

IN RE: FIRST OHIO SECURITIES COMPANY,

Debtor

PLUMBERS and STEAMFITTERS LOCAL 490 SEVERANCE AND RETIREMENT FUND, et al.,

Plaintiffs-Appellants,

and

INTERNATIONAL UNION OF BRICKLAYERS AND ALLIED CRAFTSMEN LOCAL NO. 55 HEALTH AND WELFARE FUND,

Plaintiff,

v.

WILLIAM APPLETON, TRUSTEE FOR LIQUIDATION OF THE FIRST OHIO SECURITIES COMPANY, et al.,

Defendants-Appellees.

Appendix A

ON APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE NORTHERN DISTRICT OF OHIO

BEFORE: MARTIN, NORRIS, and DAUGHTREY, Circuit Judges.

PER CURIAM. This appeal stems from a liquidation action brought under the auspices of the Security Investor Protection Act of 1970 (SIPA), as amended in 1978, 15 U.S.C. §§ 78 aaa *et seq*. The two issues before us concern the proper characterization of certain claims filed in the proceedings and the status of some of the parties who seek recovery of their losses. We find no error in the district court's ruling on these two issues and affirm.

The plaintiffs are trustees of the two union pension funds involved in this litigation, the funds' participants, and two named individual investors. Based on an agreement with a securities broker-dealer named Thomas Gilmartin, they thought they had purchased, collectively, over $3 million worth of "pooled certificates of deposit" offered by First Ohio Securities Company. But, because of fraudulent activities carried on by Gilmartin — the founder, chairman, and sole common stockholder of First Ohio Securities — the certificates were never actually purchased. Instead, Gilmartin comingled the plaintiffs' funds with his own personal assets. He then sent bogus purchase-confirmation notices and fictitious account statements to the various investors to cover his tracks.

When the Security Investor Protection Corporation initiated liquidation proceedings against First Ohio and the case was removed to bankruptcy court, the plaintiffs filed simultaneous claims with the trustee for approximately $3 million in securities and for the same amount in cash. The trustee determined that the securities in which the plaintiffs believed they had invested never

existed and, therefore, treated their claims as ones for cash, rather than for securities. The trustee also determined that the fund participants were not individual "customers" within the meaning of SIPA and wholly denied their claims. The bankruptcy court ruled in accordance with the trustee's determination on both these issues, over objections by the plaintiffs, and the district court affirmed.

The distinction between a claim for securities and a claim for cash is significant, because under SIPA, recovery for cash loss is limited to $100,000, while protection for loss of securities increases to a maximum of $500,000. 15 U.S.C. § 78 fff-3(a). Unfortunately for the plaintiffs here, the record fully supports the finding by the trustee and by both the bankruptcy and district courts that the "pooled certificates of deposit" which were the subject of the agreement between the plaintiffs and the broker-dealer not only were *not purchased* by Gilmartin but, indeed, *never even existed*. Given this fact, the only legal conclusion possible is that the claims against First Ohio were ones "for cash" and not "for securities." As the district judge noted, SIPA is intended to protect investors against a broker-dealer's insolvency; it is not designed to achieve restitution for fraud. We find no error in the district court's ruling on this issue.

The district court was equally correct in determining that the pension fund participants were not individual "customers," as that term is defined by 15 U.S.C. § 78 lll(2). *See SIPC v. Morgan, Kennedy & Co.*, 533 F.2d 1314, 1317-21 (2d Cir. 1976). Moreover, the plaintiffs' argument that *Morgan, Kennedy* is inapplicable because of subsequent amendments to SIPA is, simply, not persuasive.

For the reasons given in the district court's order in this case, we AFFIRM the judgment entered by that court.

APPENDIX B — DECISION AND ORDER FROM THE UNITED STATES DISTRICT COURT FOR THE NORTHERN DISTRICT OF OHIO FILED FEBRUARY 18, 1993

UNITED STATES DISTRICT COURT
NORTHERN DISTRICT OF OHIO

NO. 92CV0349

In re:

FIRST OHIO SECURITIES CO.,

PLUMBERS & STEAMFITTERS LOCAL NO. 490 SEVERANCE AND RETIREMENT FUND, ET AL.,

Appellants,

v.

WILLIAM APPLETON, TRUSTEE FOR THE LIQUIDATION OF FIRST OHIO SECURITIES CO.,

Appellee.

On Appeal from Case No. 590-0027 (SIPA)

ORDER

THOMAS D. LAMBROS, CHIEF JUDGE

This appeal arises out of the Bankruptcy Court's findings and order issued on the 23rd of December, 1991, regarding the Trustee's determination of claims in a proceeding involving the liquidation of a securities broker-dealer pursuant to the Securities

Appendix B

Investor Protection Act of 1970 (SIPA). This bankruptcy appeal is taken as a matter of right pursuant to 28 U.S.C. § 158(a) and Bankruptcy Rule 8001(a).

Pursuant to Bankruptcy Rule 8013, the Bankruptcy Court's "findings of fact, whether based on oral or documentary evidence, shall not be set aside unless clearly erroneous. . . ." *Accord, Stevens Industries, Inc. v. McClung*, 789 F.2d 386, 389 (6th Cir. 1986); *In re Dixon*, 85 B.R. 745 (Bankr. N.D. Ohio 1988). The Bankruptcy Court's conclusions of law, on the other hand, are subject to *de novo* review. *In re Caldwell*, 851 F.2d 852, 857 (6th Cir. 1988).

First Ohio Securities Corporation (FOSC) was a securities broker-dealer that bought and sold securities for the public. On June 22, 1990, Judge David D. Dowd, Jr., entered an order finding that the customers of FOSC were in need of protection, and the liquidation proceedings of FOSC commenced pursuant to SIPA. Customers filed claims with the trustee, and the trustee determined the validity of the claims. Subsequently, customers objected to the trustees determination and hearings were held before Judge Harold F. White. In the instant action, the trustee determined that 540 fund claim, the 490 fund claim, the 55 fund claim, and the Stansberrys' claim should be allowed as claims for cash, and consequently, the trustee paid the claimants $100,000 each. Further, the trustee determined that the claims of the individual participants in the 540 and 490 funds should be denied because they were not "customers" of FOSC as defined by the SIPA. The trustee also denied one of the Stansberrys' claim due to the fact that their account was held as joint tenants with right of survivorship. On December 23, 1991, Judge White issued his findings and order which upheld the trustee's determinations of appellants' claims.

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Appellants' first eight statement of issues all contend that the Bankruptcy Court erred when it held that the 540 fund, the 490 fund, the 55 fund, and the Stansberrys each had one claim for cash. Appellants maintain that their claims should have been valid claims for securities. If claims are for cash, the protection under the SIPA is limited to $100,000, but if the claim is for securities, the protection increases to $500,000. Appellants' assertion that the claims should have been allowed as claims for securities is not supported by the law. The Bankruptcy Court correctly determined that in order to have claim for a "security" the security must in fact exist. *SEC v. Aberdeen Securities Co.*, 480 F.2d 1121, 1126-27 (3d Cir. 1973); *See also In re Brentwood Securities, Inc.*, 925 F.2d 325, 328-29 (9th Cir. 1991).

The Securities Investor Protection Corporation (SIPC), created under the SIPA, was formed to establish a fund which would act as a limited insurance policy for customers who lose money as a result of broker-dealer insolvencies. SIPC is a non-profit corporation whose members contribute assessments which form the basis for the protection fund. The SIPA was not designed to protect customers from fraud or breach of contract, but was specifically enacted for the purpose of providing limited restitution to customers whose loss is the result of insolvent broker-dealers. *In re E.M.S. Government Securities Corp.*, 90 B.R. 539, 540-41 (Bankr. S.D. Fla. 1988); *In re Bell & Beckwith*, 124 B.R. 35, 36 (Bankr. N.D. Ohio 1990). Thereby, the appellants' claims for securities are not denied because of the fraud perpetrated, rather they are satisfied as claims for cash to the extent allowed under the SIPA. All of the rules and legislative history cited by appellants on the legitimate expectations and satisfaction of claims for securities is determinative of a security of such type being in existence. Not only were these "securities" never purchased, they never existed. Therefore, with no

evidence presented that would enable this Court to find the non-existence of the securities clearly erroneous, the conclusion of law that 490 fund, the 540 fund, the 55 fund, and the Stansberrys were each entitled to one cash claim was correct as a matter of law.

In their ninth statement of issue, appellants maintain that the Bankruptcy Court erred when it denied the claims of the individual participants in the 540 and 490 funds. SIPA defines a "customer" as,

> [A]ny person . . . who has a claim on account of securities received, acquired, or held by the debtor in the ordinary course of its business as a broker or dealer from or for the securities account of such person. . . . The term "customers" included . . . any person who has deposited cash with the debtor for the purchase of securities. 15 U.S.C. § 78 lll(2).

In *SIPC v. Morgan, Kennedy & Co.*, 53 F.2d 1314 (2d Cir. 1976), the court directly addressed the issue of whether individual participants in a pension fund were "customers" of a failed broker. The individual participants did not qualify as customers because they had no direct dealings with the broker-dealers, nor did they entrust cash or securities directly to the broker-dealers. The court held that the actual customers of the broker-dealer were the funds themselves and not the individual participants in the funds. *Morgan, Kennedy & Co.*, 533 F.2d at 1317-21. Therefore, the Bankruptcy Court was correct in denying the claims of the individual participants in the 490 and 540 funds.

In the tenth statement of issue, appellants contend that the

Appendix B

Bankruptcy Court erred in finding and concluding that the Stansberrys held one joint account with right of survivorship and not two separate accounts, thus only entitling them to one claim for cash instead of two claims for securities. The Bankruptcy Court's finding that the Stansberry account was held as joint tenants was not clearly erroneous. Evidence indicated that the confirmation statements sent to the Stansberrys were directed to David E. Stansberry and Violet M. Stansberry JTWROS (joint tenants with right of survivorship), and further, the account application form completed by Mr. Stansberry reflected that a single account was opened in the name of Mr. & Mrs. David E. Stansberry (Violet M.) JTWROS. Therefore, the Bankruptcy Court's finding that only one account existed was not clearly erroneous, nor was the conclusion that such an account entitled the holders to one cash claim against the SIPC fund in an amount not to exceed $100,000 contrary to the law. *See Morgan, Kennedy & Co.*, 533 F.2d at 1319-20; *In re Investors Security Corp.*, 6 B.R. 415, 419 (Bankr. W.D. Pa. 1980).

Therefore, after a complete review of the record, and upon full consideration of the parties' objections thereto, this Court finds that the Bankruptcy Court's findings of fact were not clearly erroneous. Additionally, after a *de novo* review of the Bankruptcy Court's conclusions of law, this Court finds that the Bankruptcy Court applied the relevant legal standards. Therefore, the Bankruptcy Court's Order Re: Objections to the Trustee's Determination of Claims and the Findings Re: Objections to the Trustee's Determination of Claims are fully adopted and incorporated herein and, thus, affirmed. Accordingly, this case is dismissed and terminated.

IT IS SO ORDERED.

Appendix B

s/ Thomas D. Lambros
Thomas D. Lambros
Chief Judge
United States District Court

AT CLEVELAND, OHIO

DATED: 2/18/93

Appendix B

UNITED STATES DISTRICT COURT
NORTHERN DISTRICT OF OHIO

NO. 92CV0349

In re:

FIRST OHIO SECURITIES CO.,

PLUMBERS & STEAMFITTERS LOCAL NO. 490 SEVERANCE AND RETIREMENT FUND, et al.,

Appellants,

v.

WILLIAM APPLETON, TRUSTEE FOR THE LIQUIDATION OF FIRST OHIO SECURITIES CO.,

Appellee.

On Appeal from Case No. 590-0027 (SIPA)

JUDGMENT

THOMAS D. LAMBROS, CHIEF JUDGE

In accordance with the Order of this date, the findings and orders of the Bankruptcy Court are fully adopted and incorporated herein, and thus, affirmed. Accordingly, this action is hereby terminated and dismissed.

IT IS SO ORDERED.

Appendix B

s/ Thomas D. Lambros
Thomas D. Lambros
Chief Judge
United States District Court

AT CLEVELAND, OHIO

DATED: 2/18/93

APPENDIX C — ORDER FROM THE UNITED STATES BANKRUPTCY COURT, NORTHERN DISTRICT OF OHIO FILED DECEMBER 23, 1991

IN THE UNITED STATES BANKRUPTCY COURT
NORTHERN DISTRICT OF OHIO

CASE NO. 590-0072
(SIPA)

IN RE

FIRST OHIO SECURITIES CO.

Debtor

ORDER RE: OBJECTIONS TO THE TRUSTEE'S DETERMINATION OF CLAIMS

In accordance with the Finding entered by this court on the 23rd day of Dec., 1991

IT IS ORDERED that:

(1) David and Violet Stansberry are entitled to one cash claim against the SIPC fund in an amount not to exceed $100,000;

(2) The Plumbers and Steamfitters Local No. 490 Severance and Retirement Fund is entitled to one cash claim against the SIPC fund in an amount not to exceed $100,000;

(3) The International Brotherhood of Electrical Workers Local No. 540 Pension Fund is entitled to one cash claim against the SIPC fund in an amount not to exceed $100,000;

Appendix C

(4) The Bricklayers Local No. 55 Health and Welfare Fund is entitled to one cash claim against the SIPC fund in an amount not to exceed $100,000;

(5) The claim of the Individual Participants in the International Brotherhood of Electrical Workers Local No. 540 Pension Fund and the Plumbers and Steamfitters Local No. 490 Severance and Retirement Fund is denied.

s/ H. F. White
H. F. White
Bankruptcy Judge

APPENDIX D — FINDINGS FROM THE UNITED STATES BANKRUPTCY COURT, NORTHERN DISTRICT OF OHIO FILED DECEMBER 23, 1991

IN THE UNITED STATES BANKRUPTCY COURT
NORTHERN DISTRICT OF OHIO

CASE NO. 590-0072
(SIPA)

FIRST OHIO SECURITIES CO.

Debtor

FINDINGS RE:
OBJECTIONS TO THE TRUSTEE'S DETERMINATION OF CLAIMS

This matter is before the court on the objections filed by the International Brotherhood of Electrical Workers Local No. 540 Pension Fund ("IBEW"); the Plumbers and Steamfitters Local No. 490 Severance and Retirement Fund ("Steamfitters"); the Bricklayers Local No. 55 Health and Welfare Fund ("Bricklayers"); the individual participants of the 540 and 490 Funds; and David and Violet Stansberry ("the Stansberrys") (collectively "claimants").[1] These claimants question the correctness of the claims determination made by the Trustee pursuant to the debtor's liquidation under the Securities Investor Protection Act ("SIPA").

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1. The objection of John and Helen Kuemerle which was filed on March 18, 1991 was withdrawn by Order of December 23, 1991. The objection of Harry and Mary Hardy has been continued.

Appendix D

FINDINGS OF FACT

1. Debtor, First Ohio Securities Company ("FOSC") was a "fully disclosed" securities broker-dealer formed for the purpose of buying and selling securities to the public. Mr. Thomas P. Gilmartin, Jr., was FOSC's chairman and sole common stockholder.[2]

2. On June 22, 1990, pursuant to an application by the Securities Investor Protection Corporation ("SIPC"), the United States District Court for the Northern District of Ohio entered an order placing FOSC in a liquidation proceeding under the Securities Investor Protection Act ("SIPA"), appointing Joseph Patchan, Esq., as Trustee ("Trustee") for the liquidation proceeding and removing the proceeding to the bankruptcy court.[3]

3. As part of his duties under SIPA, the Trustee makes a determination of customer claims. Therefore, on July 30, 1990, pursuant to the procedures mandated by SIPA, the Trustee notified FOSC's customers and creditors of the pending liquidation and informed them of the process by which they were to file any claims they may have against FOSC.

4. The Stansberrys filed a claim for securities in the amount of $190,000 pursuant to the money they gave to FOSC for investment in the All American Fund ("AAF"). The AAF was purported to be a mutual fund investing in Northeastern Ohio

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2. Mr. Gilmartin has filed an individual Chapter 7 bankruptcy proceeding in this court: Case No. 590-1242.

3. On April 19, 1991, William Appleton succeeded Joseph Patchan as Trustee.

manufacturing businesses. The Trustee determined that the Stansberrys' claim should be paid as a claim for "cash" in the amount of $100,000 since the "security" in which the Stansberrys had invested never existed. (See Exhibit No. 3 attached to Docket No. 60)

5. The Steamfitters filed a claim for securities in the amount of $1,344,220.21, plus accrued interest and a claim for cash in the amount of $103,810.11. The Trustee determined that the Steamfitters' claims should be allowed as a claim for "cash" in the amount of $100,000 since the "security" in which the Steamfitters had invested never existed. (See Exhibit No. 17 attached to Docket No. 61)

6. The IBEW filed a claim for securities in the amount of $1,440,732.14 plus accrued interest. The Trustee determined that the IBEW's claim should be allowed as a claim for "cash" in the amount of $100,000 since the "security" in which the IBEW had invested never existed. (See Exhibit No. 23 attached to Docket No. 62)

7. The Bricklayers filed a claim for securities in the amount of $200,000 plus accrued interest. The Trustee determined that the Bricklayers' claim should be allowed as a claim for "cash" in the amount of $100,000 since the "security" in which the Bricklayers had invested never existed. (See Exhibit No. 3 attached to Docket No. 64)

8. The Trustee determined that the claims filed on behalf of the individual participants in both the IBEW 540 Fund and the Steamfitters 490 Fund should be denied because the individual claimants were not "customers" of the debtor, the securities were not "customer name securities" and the securities were not

"customer property" within the meaning of SIPA. (See Exhibit No. 1 attached to Docket No. 59)

9. With the exception of the claims filed by the individual participants in the IBEW 540 Fund and the Steamfitters 490 Fund, the Trustee has paid each of the claimants $100,000 on their claims. The claims of the individual participants were denied.

10. A hearing on the objections was held on May 9, 30, and 31, 1991. Mr. Howard Klein, who is a forensic accountant, testified as an expert witness for the Trustee. Mr. Klein has been employed by the Trustee to investigate the books and records of FOSC. This court is familiar with the expertise and qualifications of Mr. Klein, since he has testified as an expert witness in other cases before this court.

11. The Stansberrys gave Mr. Gilmartin two checks payable to FOSC and totalling $190,000 for the purchase of shares in the AAF. Mr. Gilmartin told them that this money would be invested in companies located in Northeastern Ohio in order to enable those companies to compete with foreign imports. (Stansberry Exhibit No. 5 and May 5 Tr. pp. 36-40, 45) (The citations to "Tr." refer to the transcripts from the May 9, 30, and 31, 1991 hearing, Docket Nos. 111-113.) The "New Account Form" that Mr. Stansberry filled out when he invested with FOSC shows that the Stansberrys were put on notice that their account was a "JTWROS" account, *i.e.*, an account in joint tenancy with the right of survivorship. The Stansberrys were listed on FOSC's books and records as a "JTWROS" account. (Stansberry Exhibits Nos. 6 & 7 and May 9 Tr. p. 48) The Stansberrys' checks were deposited at the First National Bank of Ohio in account number 5068-7886. (May 30 Tr. pp. 164-166, 172) This bank account was

in the name of First Ohio Investment Company ("FOIC"). (May 30 Tr. pp. 165, 172) FOIC was found to be merely a "dba" of Mr. Gilmartin. (May 31 Tr. pp. 33-34) Even though the Stansberrys received several interest payments from their investment, the evidence shows that no funds from the FOIC account were ever used to purchase an investment in the AAF for the Stansberrys. (May 9 Tr. p. 54 and May 30 Tr. p 174) Although during his investigation Mr. Klein had seen documents pertaining to the AAF there was nothing to show that such an entity actually had been formed. (May 30 Tr. pp. 182-183, May 31 Tr. pp. 15-16) Although there is an existing corporation called "All America Fund, Inc.", there never was an AAF. All of the cash that was intended to go into the AAF went into the FOIC account instead and was commingled with Mr. Gilmartin's personal assets. (May 31 Tr. pp. 15-16, 34, 56-57, 67-68 & 83-84)

12. The Plumbers and Steamfitters Local No. 490 Severance and Retirement Fund is a union-negotiated defined contribution pension and severance plan. (May 30 Tr. p. 24) The Fund is under the control of a Board of Trustees pursuant to a Trust document and it is the Trustees who make the investment decisions for the Fund. (May 30 Tr. pp. 27 & 84) Each individual participant in the Fund earns interest on his own contribution, but has no direct voice in investment decisions concerning the Fund. (May 30 Tr. pp. 82-83) The Steamfitters' account with FOSC was not in the name of the individuals who contributed to the Fund, but was in the name of the Steamfitters. (May 30 Tr. p. 82) The Fund is administered by a contract administrator which acts as an advisor to the Trustees concerning the daily operations of the Fund. (May 30 Tr. pp. 27-28, 69) The Steamfitters' Trustees believed that they were investing funds in FOSC for three certificates of deposit. (May 30 Tr. p. 45) Even though the Steamfitters received confirmation statements from FOSC

documenting the purchase of the certificates of deposit, there is no indication in FOSC's books and records that any certificates of deposit were purchased on the Steamfitters' behalf. (May 30 Tr. pp. 51-52, 54-57, 166-169, 173-174) However, there is evidence that the confirmation statements were fraudulent and that the funds that the Steamfitters gave to FOSC were deposited in the FOIC account and used by Mr. Gilmartin for his personal benefit. (May 30 Tr. pp. 166-170, 175-178 and May 31 Tr. pp. 16 & 83-84)

13. The International Brotherhood of Electrical Workers Local No. 540 Pension Fund is a Multi-employer 401(k) defined benefit pension plan. (May 9 Tr. p. 63) The Fund is governed by a Board of Trustees and administrated by a contract administrator. (May 9 Tr. pp. 26 & 64, 69-70) The individual participants in the Fund could not participate in making investment decisions concerning the Fund. Those decisions were made by the Board of Trustees. (May 9 Tr. pp. 28-31, 69-70, 101) The Fund invested money with FOSC for certificates of deposit. (May 9 Tr. pp. 64-67, 69-70, 74-75, 80) Just as with the Steamfitters, the IBEW received fraudulent confirmation statements from FOSC purporting to document the purchase of the certificates. (May 9, Tr. pp. 70-72, 76, 79, 81, May 30, Tr. pp. 175-178) There is no evidence that the certificates ever existed; however, there is evidence that the IBEW's funds were deposited into the FOIC account and used by Mr. Gilmartin for his personal benefit. (May 9 Tr. p. 75; May 30 Tr. pp. 164-167, 171, 173 and May 31 Tr. pp. 80-83)

14. The Bricklayers Local No. 55 Health and Welfare Fund is a negotiated hospitalization, life insurance, and weekly disability benefit plan. (May 30 Tr. p. 114) It is governed by a Trust Agreement and a Board of Trustees. The Bricklayers also have investment advisors. (May 30 Tr. p. 115) Although the Fund

comprises the participants' individual contributions, the individual participants in the Fund have no direct input in making investment decisions. (May 30 Tr. pp. 132-134) The only way that the individual participants have any input as to how the Fund is handled is through their election of the labor Trustees. (May 30 Tr. p. 134) The Bricklayers believed that they were purchasing certificates of deposit by investing in a Pension & Public Funds Trust Account ("PPFTA"). (May 30 Tr. p. 136) However, the PPFTA never existed. (May 31 Tr. pp. 2-3, 6-7) Instead, the Bricklayers' money went into the FOIC account and was used for Mr. Gilmartin's personal benefit. (May 30 Tr. p. 171 and May 31 Tr. pp. 80-83) The Bricklayers received a "statement" from FOSC purporting to reflect the purchase of the certificates of deposit. (May 30 Tr. pp. 128-129) However, when they failed to receive an actual confirmation of the purchase, they were alerted that there might be a problem. (May 30 Tr. p. 129)

ISSUE

Should this court ratify the Trustee's determination of these claims?

CONCLUSIONS OF LAW

This court has jurisdiction to determine this question pursuant to 28 U.S.C. § 157(b)(1) which provides:

> Bankruptcy judges may hear and determine all cases under title 11 and all core proceedings arising under title 11, or arising in a case under title 11, referred under subsection (a) of this section, and may enter appropriate orders and judgments, subject to review under section 158 of this title.

Appendix D

Title 28 U.S.C. § 157(b)(2)(B) provides that core proceedings shall include allowance or disallowance of claims against the estate.

The claimants in this proceeding object to the Trustee's determination of their claims pursuant to the Securities Investor Protection Act, 15 U.S.C. §§ 78aaa, *et seq.* SIPA was enacted by Congress in 1970 to protect individual investors from financial hardship resulting from broker-dealer failures. The Securities Investor Protection Corporation is a non-profit corporation which comprises most registered brokers-dealers. Members of SIPC are assessed in order to create a fund which is used to satisfy customer claims resulting from broker-dealer insolvencies. *See* 15 U.S.C. §§ 78aaa *et seq.* and H.R. Rep. No. 1613, 91st Cong., 2d Sess. (1970), *reprinted in* 1970 U.S. Code Cong. & Admin. News 5254, 5257. Pursuant to 15 U.S.C. § 78fff-3(a), SIPC funds are available for the satisfaction of customer claims to the extent that the customers' net equities exceed their ratable share of customer property. Section 78fff-3 provides in part:

> (a) ADVANCES FOR CUSTOMERS' CLAIMS
>
> In order to provide for prompt payment and satisfaction of net equity claims of customers of the debtor, SIPC shall advance to the trustee such moneys, not to exceed $500,000 for each customer, as may be required to pay or otherwise satisfy claims for the amount by which the net equity of each customer exceeds his ratable share of customer property, except that—
>
> (1) if all or any portion of the net equity claim of a customer in excess of his ratable

> share of customer property is a claim for cash, as distinct from a claim for securities, the amount advanced to satisfy such claim for cash shall not exceed $100,000 for each such customer;

A SIPA liquidation is essentially a bankruptcy proceeding which has been remodelled to achieve the special purposes of SIPA. *See Matter of Bevill, Bresler & Schulman, Inc.*, 83 B. R. 880, 886 (D.N.J. 1988); *Securities Investor Protection Corporation v. Ambassador Church Finance/Development Group, Inc.*, 788 F. 2d 1208, 1210 (6th Cir. 1986), *cert. denied sub nom. Pine Street Baptist Church v. Securities Investor Protection Corp.*, 479 U. S. 850 (1986) and Title 15 U.S.C. § 78fff(b). In order to show that he is entitled to SIPC protection, the claimant must show that he was a "customer" of an insolvent broker-dealer. "An investor is entitled to compensation from the SIPC only if he has entrusted cash or securities to a broker-dealer who becomes insolvent; if an investor has not so entrusted cash or securities, he is not a customer and therefore not entitled to recover from the SIPC trust fund." *In re Brentwood Securities. Inc.*, 925 F. 2d 325, 327 (9th Cir. 1991) The burden of proof of a claim falls upon the claimant since § 78fff-2(b) provides that a Trustee shall promptly discharge the debtor's obligations to a customer insofar as such obligations are ascertainable from the debtor's books and records or are "*otherwise established to the satisfaction of the trustee*" (emphasis added). Claims are to be valued as of the "filing date"; that is, as of the date that SIPA files its application for a protective decree. A customer's claim is based on that customer's "net equity" as was shown on the debtor's books on the "filing date." *In re Bell & Beckwith*, 821 F. 2d 333, 335 (6th Cir. 1987); *S.E.C. v. Aberdeen Securities Co.*, 480 F. 2d 1121, 1123-1124 (3rd Cir. 1973), *cert. denied sub nom. Seligsohn v. S.E.C.*, 414 U.S. 1111 (1973) and 15 U.S.C. § 78fff

and 78111(2), (7) & (11). Although SIPA protects against customers' losses caused by the insolvency of a broker-dealer, SIPA was not designed to protect customers from fraud or breach of contract. *In re Bell & Beckwith,* 124 B. R. 35, 36 (Bankr. N. D. Ohio 1990) and *In re Government Securities Corp.*, 90 B. R. 539, 540 (Bankr. S. D. Fla. 1988)

THE STANSBERRYS' CLAIM

The Trustee determined that the Stansberrys' $190,000 claim should be allowed as a claim for cash in the amount of $100,000 rather than as a claim for a security since the AAF in which the Stansberrys believed they had invested actually never existed. (Findings Nos. 4 & 11) This determination is detrimental to the Stansberrys since pursuant to § 78fff-3(a) and (a)(1), claims for securities are covered to an amount not to exceed $500,000, while claims for cash are not to be satisfied in an amount exceeding $100,000. The Stansberrys argue that their claim is one for securities and that it is not a condition precedent to payment that the securities actually exist.

However, this court concludes that the Stansberrys have a claim for cash, not securities, since there is no evidence that the securities were ever purchased. (Finding No. 11) In the *Matter of Investors SEC. Corp.*, 6 B. R. 415 (1980), the husband and wife claimants had given money to a representative of an investment corporation with the understanding that the money would be invested in certificates of deposit. There was no evidence that the certificates had ever been purchased, even though the claimants in that case had received timely interest payments. When the investment corporation went into a SIPA liquidation, the Trustee determined that the claim was one for cash, while the claimants argued that the claim was one for securities. However, the court

there found that the claim was one for cash and that SIPA "contemplates situations, such as this one, where money is deposited with the broker for the purpose of purchasing securities, but where the broker has failed to purchase the securities." *Id.* at 419. Furthermore, this court concludes that in order for the Stansberrys to have a claim for "securities", the securities must have been in existence. In *Aberdeen Securities,* the claimants advanced funds to a broker to purchase securities which were never issued. The Third Circuit Court of Appeals held that because the stock was not in existence, the purchase never could have been made and therefore the claim would be for cash, not for the stock itself. 480 F. 2d 1121 at 1127. *See also In re Brentwood Securities Inc.,* 925 F. 2d 325 at 328.

The Stansberrys further argue that they had two separate accounts with FOSC; however there is no evidence of this. The evidence shows that the Stansberrys had one "JTWROS" account, *i.e.,* a joint account with the right of survivorship. (Finding No. 11) A joint account with the right of survivorship is entitled to one recovery. Pursuant to the Rules Relating to Satisfaction of a "Claim for Cash" or a "Claim for Securities", SIPC Rule 105 — Joint Accounts, provides:

> (a) *A joint account shall be deemed to be a "qualifying joint account" if it is owned jointly,* whether by the owners thereof *as joint tenants with the right of survivorship,* as tenants by the entirety or as tenants in common, or by husband and wife as community property, but only if each co-owner possesses authority to act with respect to the entire account.
>
> (b) Subject to paragraph (c) of this rule, *each*

> *qualifying joint account with a member shall be deemed held by one separate customer of the member.* (Emphasis added.)

In *SEC. Investor Protection v. Morgan. Kennedy & Co.*, 533 F. 2d 1314 (2d Cir. 1976), *cert. denied sub nom. Trustees of Reading Body Works. Inc. v. Securities Investor Protection Corp.*, 426 U. S. 936 (1976), three Trustees who jointly managed the account for a trust which was the "true customer" of SIPC argued that they each had a separate customer claim. Disagreeing with this argument, the Second Circuit Court of Appeals held that:

> If the available maximum of a SIPC advance depended upon the number of parties jointly holding an account, individuals could arbitrarily expand that figure at will. Such a result is obviously repugnant to the plain meaning of the statute and to the intent of Congress in passing it. Accordingly, we hold that the three trustees, by virtue of the trust account held by them collectively, may advance one customer claim only against the debtor.

Id. at 1321.

See also Matter of Investors SEC. Corp., 6 B. R. 415 at 419.

Thus, this court concludes that the Stansberrys are the holders of one "qualifying joint account" and as such are entitled to one cash claim against the SIPC fund in an amount not to exceed $100,000.

Appendix D

THE STEAMFITTERS' CLAIM

The Trustee determined that the Steamfitters' claim should be allowed as a claim for cash in the amount of $100,000 rather than as a claim for a security since the certificates of deposit in which the Steamfitters believed they had invested never existed. (Findings Nos. 5 & 12) The Steamfitters argue that the "confirmations" that they received are sufficient evidence that the certificates of deposit actually existed, or in the alternative, that it is irrelevant that the certificates were nonexistent.

However, after reviewing the testimony, this court concludes that the certificates were never purchased; and as previously discussed, in order to have a claim for a "security" the security must in fact exist. *See Matter of Investors SEC. Corp.*, 6 B. R. 415 at 419 and *Aberdeen Securities*, 480 F. 2d 1121 at 1127.

Therefore, this court concludes that the Steamfitters are entitled to one cash claim against the SIPC fund in an amount not to exceed $100,000.

THE IBEW'S CLAIM

The Trustee determined that the IBEW's claim should be allowed as a claim for cash in the amount of $100,000 since the certificates of deposit in which it believed it had invested never existed. (Findings Nos. 7 & 13) The IBEW argues that the "confirmations" that it received, albeit fraudulent, are sufficient evidence of the certificates, or in the alternative, that the nonexistence of the certificates is irrelevant. However, as previously discussed, in order to have a claim for a "security", that security must in fact exist. *See Matter of Investors SEC. Corp.*, 6 B. R. 415 at 419 and *Aberdeen Securities*, 480 F. 2d 1121 at 1127.

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From the evidence, this court concludes that the certificates of deposit never existed; therefore, the IBEW is entitled to one cash claim against the SIPC fund in an amount not to exceed $100,000.

THE BRICKLAYERS' CLAIM

The Trustee determined that the Bricklayers' claim should be allowed as a claim for cash in the amount of $100,00 since neither the PPFTA nor the certificates of deposit in which the Bricklayers believed they had invested actually ever existed. (Findings Nos. 7 & 14) The Bricklayers argue that the nonexistence of the certificates is irrelevant and that the "statement" which they had received from FOSC is sufficient evidence to meet their burden of proof that the certificates in fact existed.

However, after reviewing the testimony, this court concludes that the certificates never existed. Since in order to have a claim for a "security" the security must in fact exist, the Bricklayers are entitled to only one cash claim against the SIPC fund in an amount not to exceed $100,000. *See Matter of Investors SEC. Corp.*, 6 B. R. 415 at 419.

THE CLAIM OF THE INDIVIDUAL PARTICIPANTS IN THE IBEW 540 AND THE STEAMFITTERS 490 FUNDS

The Trustee determined that the claims filed on behalf of the individual participants in the IBEW 540 Fund and the Steamfitters 490 Fund should be denied because these *individual claimants* were not "customers" of the debtor. (Finding No. 8) This court agrees with that determination. The evidence shows that the actual customers were the "Funds", not the individual participants in the Funds. (Findings Nos. 12 and 13)

Appendix D

Pursuant to 15 U.S.C. § 78lll(2), a customer is defined as follows:

> The term "customer" of a debtor means any person . . . who has a claim on account of securities received, acquired, or held by the debtor in the ordinary course of its business as a broker or dealer from or for the securities accounts of such person. . . . The term "customer" includes . . . any person who has deposited cash with the debtor for the purpose of purchasing securities, ...

In *SEC. Investor Protection v. Morgan. Kennedy & Co.*, 533 F. 2d 1314 at 1315, the Second Circuit Court of appeals was asked to determine whether or not the employee-beneficiaries of a profit-sharing plan trust qualified as "customers" for the purpose of participating in the SIPC fund. In that case, as in this one, the trust fund assets were managed by Trustees who made the actual investment decisions. *Id.* at 1315. The Bankruptcy Court had ruled in the employee-beneficiaries' favor. However, the Appeals Court reversed and held that:

> The employee-beneficiaries in the case before us made no purchases, transacted no business, and had no dealings whatsoever with the broker-dealer in question respecting the trust account. Indeed, they could not have any such dealings since the broker-dealer held no property belonging to any individual employee, in which such employee could trade or invest. Calculable amounts were payable to Reading's employees only in the

> event that, pursuant to the terms of the Plan, they became entitled thereto. The argument that, notwithstanding their complete anonymity and total incapacity to have dealings with the broker-debtor, the Reading employees were "customers" of Morgan-Kennedy stretches that term wholly beyond its limits. *Id.* at 1318.

In this case, as in the *Morgan. Kennedy & Co.* case, the individual participants in the Funds had no dealings with the broker-dealer and had no direct input into the investment decisions. (Findings Nos. 12 & 13) Therefore, this court concludes that the individual participants in the 540 and 490 Funds are not "customers" as defined by SIPA, and therefore these claims should be denied.

A separate Order in accordance with these Findings shall be entered.

s/ H. F. White
H. F. White
Bankruptcy Judge

I certify that on the 23rd day of Dec, 1991, I sent a copy of this Finding and Order to:

Thomas R. Lucchesi
Baker & Hostetler
3200 National City Center
Cleveland, Ohio 44114

Appendix D

William B. Gore
Laybourne, Smith, Gore & Goldsmith
159 South Main Street
Suite 503
Akron, Ohio 44308

Josephine Wang
Securities Investor
Protection Corporation
805 Fifteenth Street, N. W.
Suite 800
Washington, D. C. 20005-2207

s/ Eileen Sears

APPENDIX E — ORDER FROM THE UNITED STATES DISTRICT COURT FOR THE NORTHERN DISTRICT OF OHIO FILED JUNE 22, 1990

UNITED STATES DISTRICT COURT
NORTHERN DISTRICT OF OHIO

Civil Action No. 5:90CV1125

SECURITIES INVESTOR PROTECTION CORPORATION,

Plaintiff-Applicant,

v.

FIRST OHIO SECURITIES CO.,

Defendant.

ORDER

On the complaint and application of the SECURITIES INVESTOR PROTECTION CORPORATION ("SIPC"), it is hereby:

I. ORDERED, ADJUDGED and DECREED, that the customers of First Ohio Securities Co. ("Defendant"), are in need of the protection afforded by the Securities Investor Protection Act ("SIPA").

II. ORDERED that pursuant to section 78eee(b)(3) of SIPA, 15 U.S.C.A. § 78eee(b)(3) (1981), Joseph Patchan, Esquire, is hereby appointed trustee for the liquidation of the business of the Defendant with all the duties and powers of a trustee as prescribed in SIPA, and the law firm of Baker & Hostetler is hereby appointed counsel for said trustee. Said trustee shall file a fidelity bond satisfactory to the Court in the amount of $100.00.

Appendix E

III. ORDERED that creditors and all other persons or entities are hereby notified that the automatic stay provisions of section 362(a) of the Bankruptcy Code, 11 U.S.C.A. § 362(a) (1979), *as amended by* Pub. L. No. 97-222, 96 Stat. 235 (July 27, 1982), operate as a stay of:

> (i) the commencement or continuation, including the issuance or employment of process, of a judicial, administrative, or other proceeding against the Defendant that was or could have been commenced before the commencement of this proceeding, or to recover a claim against the Defendant that arose before the commencement of this proceeding;
>
> (ii) the enforcement, against the Defendant or against property of the estate, of a judgment obtained before the commencement of this proceeding;
>
> (iii) any act to obtain possession of property of the estate or of property from the estate;
>
> (iv) any act to create, perfect, or enforce any lien against property of the estate;
>
> (v) any act to create, perfect, or enforce against property of the Defendant any lien to the extent that such lien secures a claim that arose before the commencement of this proceeding;

(vi) any act to collect, assess, or recover a claim against the Defendant that arose before the commencement of this proceeding;

(vii) the setoff of any debt owing to the Defendant that arose before the commencement of this proceeding against any claim against the Defendant; and

(viii) the commencement or continuation of a proceeding before the United States Tax Court concerning the Defendant.

IV. ORDERED that pursuant to section 78eee(b)(2)(B)(i) of SIPA, 15 U.S.C.A. § 78eee(b)(2)(B)(i) (1981), any pending bankruptcy, mortgage foreclosure, equity receivership, or other proceeding to reorganize, conserve, or liquidate the debtor or its property and any other suit against any receiver, conservator, or trustee of the debtor or its property, is hereby stayed.

V. ORDERED that pursuant to sections 78eee(b)(2)(B)(ii) and (iii) of SIPA, 15 U.S.C.A. §§ 78eee(b)(2)(B)(ii) and (iii) (1985), and notwithstanding the provisions of sections 555 and 559 of the Bankruptcy Code, 11 U.S.C.A. §§ 555 and 559 (1985), all creditors of Defendant and all other persons be, and they hereby are, stayed, enjoined and restrained for a period of twenty-one (21) days or such other time as may subsequently be ordered by this Court or any other court having competent jurisdiction of this proceeding, from exercising any right of setoff; and from causing the liquidation of a repurchase agreement as defined in section 101(39) of the Bankruptcy Code, 11 U.S.C.A. § 101(39) (1985), without first receiving the written consent of SIPC and the trustee to such liquidation.

Appendix E

VI. ORDERED that Defendant, its officers, directors, shareholders, employees and any other person or persons are hereby stayed, enjoined and restrained from directly or indirectly removing, transferring, setting-off, receiving, retaining, changing, selling, pledging, assigning, or otherwise disposing of, withdrawing or interfering with any assets or property owned, controlled or in the possession of Defendant, including but not limited to customers' securities and free credit balances, except for the purpose of effecting possession and control of said property by the trustee.

VII. ORDERED that pursuant to sections 5(b)(2)(B)(ii) and (iii) of SIPA, 15 U.S.C.A. § 78eee(b)(2)(B)(ii) and (iii) (1988), and notwithstanding the provisions of section 555 of the Bankruptcy Code, 11 U.S.C.A. § 555 (1988), all stockbrokers, financial institutions, and securities clearing agencies, as defined in section 101 of the Bankruptcy Code, 11 U.S.C.A. § 101, be, and they hereby are, stayed, enjoined, and restrained for a period of twenty-one (21) days or such other time as may subsequently be ordered by this Court or any other court having competent jurisdiction of this proceeding, from exercising a contractual right to cause the liquidation of a contract for the loan of a security within the meaning of section 741(7) of the Bankruptcy Code, 11 U.S.C.A. § 741(7) (1988), without first receiving the written consent of SIPC and the trustee.

VIII. ORDERED that the stays set forth above shall not apply to (a) any suit, action or proceeding brought or to be brought by the Securities and Exchange Commission or any self-regulatory organization of which Defendant is now a member or was a member within the past six months; or (b) the exercise of a contractual right of any securities clearing agency to cause the liquidation of a securities contract as defined in section 741(7) of

the Bankruptcy Code, 11 U.S.C. § 741(7) (1979), *as amended by* Pub. L. No. 97-222, 96 Stat. 235 (July 27, 1982); or (c) any setoff or liquidating transaction undertaken pursuant to its rules or bylaws by any securities clearing agency registered under section 17(a) of the Securities Exchange Act of 1934 or by any person acting under instructions from and on behalf of such a securities clearing agency; or (d) any settlement transaction undertaken by such securities clearing agency using securities in its custody or control, provided that the entire proceeds thereof, without benefit of any offset, are promptly turned over to the receiver, or a subsequent trustee, appointed herein.

IX. ORDERED that pursuant to section 78eee(b)(4) of SIPA, 15 U.S.C.A. § 78eee(b)(4) (1981), this liquidation proceeding (not including any action brought herein by the Securities and Exchange Commission) is removed to the United States Bankruptcy Court for this District.

X. ORDERED that the trustee is authorized to open accounts and obtain a safe deposit box at a bank or banks to be chosen by the trustee, and the trustee may designate such of his representatives who shall be authorized to have access thereto.

s/ Judge Dowd
UNITED STATES DISTRICT JUDGE

Entry of the within Order is hereby consented to:

FIRST OHIO SECURITIES CO.

By _____ Date: June ___, 1990

_____ Date: June ___,1990
SECURITIES INVESTOR PROTECTION
CORPORATION

(2)

Supreme Court, U.S.
FILED
MAR 2 1995
OFFICE OF THE CLERK

No. 94-1286

IN THE
Supreme Court of the United States
OCTOBER TERM, 1994

PLUMBERS & STEAMFITTERS LOCAL 490 SEVERANCE AND RETIREMENT FUND; THE INDIVIDUAL PARTICIPANTS IN THE PLUMBERS & STEAMFITTERS LOCAL 490 SEVERANCE AND RETIREMENT FUND,
Petitioners,

vs.

WILLIAM APPLETON, TRUSTEE FOR THE LIQUIDATION OF FIRST OHIO SECURITIES COMPANY; AND SECURITIES INVESTOR PROTECTION CORPORATION,
Respondents.

On Petition For Writ Of Certiorari To The United States Court Of Appeals For The Sixth Circuit

BRIEF OF RESPONDENTS IN OPPOSITION TO THE PETITION FOR WRIT OF CERTIORARI

Thomas R. Lucchesi
Counsel of Record
Hilary W. Rule
BAKER & HOSTETLER
3200 National City Center
Cleveland, Ohio 44114
Telephone: (216) 621-0200
Attorneys for William Appleton, Trustee

Michael E. Don
Acting General Counsel
Counsel of Record
SECURITIES INVESTOR PROTECTION CORPORATION
805 Fifteenth Street, N.W.
Suite 800
Washington, D. C. 20005
Telephone: (202) 371-8300

Of Counsel:

Josephine Wang
Associate General Counsel

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COUNTERSTATEMENT OF THE QUESTIONS PRESENTED FOR REVIEW

First Ohio Securities Co. ("FOSC" or "the Debtor"), a securities brokerage firm, was placed in liquidation under the Securities Investor Protection Act, 15 U.S.C. §78aaa et seq. ("SIPA").* A trustee ("Trustee") was appointed for the firm who, consistent with SIPA, provided notice of the proceeding and claims materials to customers and other creditors of FOSC. Among the claims that were filed with the Trustee were those of Petitioners Plumbers & Steamfitters Local 490 Severance and Retirement Fund ("490 Fund" or the "Fund"), and its beneficiaries, the Individual Participants. Each sought, as a "customer" under SIPA, the return of cash and securities. The Trustee denied the claims of the Individual Participants on the ground that the Participants were not "customers." The claim of the 490 Fund was allowed. However, because the certificates of deposit ("CDs") which it sought were non-existent, the claim was treated, in its entirety, as one for cash. The cash portion of a customer claim is protected up to $100,000 under SIPA, and the Fund received that amount. But because the securities portion of a claim is protected up to $500,000 under SIPA, the petitioners seek to increase their protection by asserting that 1) each of the Participants is a "customer" under SIPA; 2) the claims of the petitioners should be allowed as ones for securities and not cash; and 3) in any event, the petitioners' losses resulted from the fraud of the broker and those losses therefore, should be protected by the Securities Investor Protection Corporation ("SIPC"). Thus, the issues presented are

I. In view of the fact that the intent of SIPA is to protect the "customer" as market investor or trader, whether a beneficiary of a trust is a "customer," for

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* For convenience, references herein to provisions of SIPA shall omit "15 U.S.C."

purposes of SIPA protection, where 1) the beneficiary does not have an account with the debtor brokerage firm, the account having been established only in the name of the trust; 2) the broker does not know the identity of the beneficiary; 3) the beneficiary receives no account statements from the broker or its clearing firm; and 4) the beneficiary has no authority to make trading decisions, all such decisions being made solely by the trust.

II. Whether a customer has a claim for "securities" under SIPA if the securities allegedly bought by the claimant are fictitious.

III. In view of the fact that SIPA protects customers only as to losses arising directly out of the financial failure of the broker by returning to them the cash and securities owed to them on the "filing date" (generally the date on which SIPC files the application to have the firm placed in liquidation), whether investors whose claims are for damages preceding the filing date and resulting from the broker's fraud are eligible for SIPA protection.

LIST OF PARTIES

The parties to the proceeding before the United States Court of Appeals for the Sixth Circuit were as follows:

1. The 490 Fund;

2. International Brotherhood of Electrical Workers Local 540 Pension Fund;

3. The Individual Participants in the 490 Fund;

4. The Individual Participants in the International Brotherhood of Electrical Workers Local 540 Pension Fund;

5. David and Violet Stansberry;

6. William Appleton, Trustee for the Liquidation of First Ohio Securities Co.; and

7. SIPC.

Although the International Union of Bricklayers and Allied Craftsmen, Health & Welfare Fund Local 55, was a party to the proceeding before the Bankruptcy Court, it did not appeal from the order of that court.

Only the 490 Fund and its individual participants seek review from the order of the Court of Appeals.

SIPC was created pursuant to a federal statute, and has no parent companies or subsidiaries.**

** SIPC's participation in this matter has been pursuant to SIPA section 78eee(d). In pertinent part, under that provision, SIPC is a party in interest as to all matters arising in a SIPA liquidation proceeding, "with the right to be heard on all such matters."

STATUTORY PROVISIONS

There is no issue in this case involving an interpretation of SIPA section 78fff(c). See Petition for Writ of Certiorari ("Cert. Pet.") at 2. That provision relates to customer transactions occurring after the "filing date." The "filing date" generally is the date on which SIPC files the application in district court to have the broker-dealer placed in SIPA liquidation, but also may mean the date on which a receiver, trustee, or liquidator, is appointed for a broker in a suit preceding the commencement of the SIPA case against it. SIPA §78lll(7). The latter circumstance is not present, and section 78fff(c) is erroneously cited by the petitioners as a provision involved in this case.

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No. 94-1286

IN THE
Supreme Court of the United States
OCTOBER TERM, 1994

PLUMBERS & STEAMFITTERS LOCAL 490 SEVERANCE AND RETIREMENT FUND; THE INDIVIDUAL PARTICIPANTS IN THE PLUMBERS & STEAMFITTERS LOCAL 490 SEVERANCE AND RETIREMENT FUND,
Petitioners,

vs.

WILLIAM APPLETON, TRUSTEE FOR THE LIQUIDATION OF FIRST OHIO SECURITIES COMPANY; AND SECURITIES INVESTOR PROTECTION CORPORATION,
Respondents.

BRIEF OF RESPONDENTS IN OPPOSITION TO THE PETITION FOR WRIT OF CERTIORARI

COUNTERSTATEMENT OF THE CASE

This contested matter arises in the context of the liquidation proceeding under SIPA of FOSC, formerly a securities brokerage firm. Having given notice of the commencement of the proceeding and mailed copies of the notice and claim materials to customers and other creditors of the Debtor, the Trustee for FOSC received claims asserting "customer" status from, among others, the 490 Fund and its beneficiaries, the Individual Participants. The Fund claimed approximately $1.3 million in securities and $103,000 in cash.

The Participants sought cash balances amounting to their individual shares of the sums owed to the Fund. Following analysis and research of the claims, the Trustee denied those of the Participants because the latter were not "customers" under SIPA. The claim of the 490 Fund was allowed as a "customer" claim. However, because the Fund had invested in "securities" that did not exist, its entire claim was determined to be one for cash. Pursuant to SIPA section 78fff-3(a)(1), the Fund received in partial satisfaction of the amount owed to it, $100,000 advanced by SIPC.[1]

The petitioners objected to the determinations,[2] seeking to avail themselves of more protection from SIPC by arguing that 1) the Participants were "customers" and therefore, each was entitled to protection; 2) the Trustee had erred in determining the claim of the 490 Fund to be for cash and not securities; and 3) SIPA protects claims for damages that result from fraud. The same arguments were considered by each of the three lower courts. Each argument was rejected by each court.[3]

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[1] In addition to the SIPC advance, the 490 Fund is entitled to receive its *pro rata* share of the fund of customer property and of the general estate, if any. SIPA §78fff-2(c)(1).

[2] The filing of the objections created a contested matter under Bankruptcy Rule 9014. See Advisory Committee Note to Rule 9014 ("filing of an objection to a proof of claim ... creates a dispute which is a contested matter.")

[3] Because the 490 Fund misapprehends the manner in which claims for securities are satisfied under SIPA, it asserts that the protection would have been greater if its claim had been allowed as one for securities. Cert. Pet. at 15. In fact, it would have been much less. If a security claimed is not among the Debtor's assets, the Trustee purchases it for the customer if the security can be bought in a fair and orderly market. If not, the customer receives the filing date market value of the security, which in this case is the value on the date SIPC filed the application to have FOSC placed in liquidation. SIPA §§78fff-2(b) and (d) and 78*lll*(7). Had the claim of the 490 Fund been allowed as one for securities, the petitioner would have received nothing. The CDs in

SUMMARY OF THE ARGUMENT

The Court should deny the petition for a writ of certiorari for the following reasons:

1. In viewing the 490 Fund and not the Participants as the "customer" under SIPA, the decision of the Sixth Circuit is in accord with the applicable law on the question, that is, *SIPC v. Morgan Kennedy*, 533 F.2d 1314 (2d Cir.), *cert. den. sub nom., Trustees of Reading Body Works, Inc. v. SIPC*, 426 U.S. 936 (1976) ("*Morgan Kennedy*"), and SIPC Rule 104, 17 C.F.R. §300.104 ("Rule 104"). As reflected in *Morgan Kennedy* and Rule 104, the intent of SIPA is to protect the market participant as investor or trader, and not third party beneficiaries who stand to profit from such trading. Instilling confidence in the safety of his investments in the person who does the actual trading, promotes stability in the marketplace. In the case at hand, the market participant was the trust, that is, the 490 Fund, and not its individual beneficiaries. The account at the broker was in the name of the trust. Only it could make trading decisions. And it alone received account statements from the broker or its clearing firm.

In that regard, that the Participants are not "customers" is apparent from a review of the customer definition itself. Having no account at the broker, the Participants would not have a claim on account of securities received, acquired or held by the broker "for the securities accounts of such person." SIPA §78*lll*(2). Moreover, inasmuch as the monies were deposited with the broker by the Fund itself, and not the Participants, the latter could not be "customers" by reason of having "deposited cash with the debtor." *Id.*

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this case were fictitious and therefore could not have been bought for the Fund. Moreover, the filing date value of a nonexistent "security" must be zero. Instead of nothing, the Fund received $100,000 from SIPC.

2. There also is no conflict among the Circuits on the issue of whether the claim was for cash or for securities. The claim of the 490 Fund correctly was determined to be for cash. The Fund's cash was on deposit with the Debtor for the purpose of buying CDs which are securities under SIPA. Hence, the Fund was a "customer" under SIPA section 78*lll*(2), eligible for some form of protection. The extent of protection depended on whether cash or securities were being held for it on the "filing date." SIPA §§78fff-2(c) and 78*lll*(11). See *supra*, n.3. If, as in the case at hand, a security never existed, there can be none for the customer to claim. In that circumstance, the claim is not for a "security," but for the return of the cash that the customer tendered to the broker for the purchase.

The fact that the CDs were fictitious was uncontested at trial, and in any event, would present no issue worthy of review by this Court. *United States v. Johnson*, 268 U.S. 220, 227 (1925) (court does "not grant a certiorari to review evidence and discuss specific facts"). The cases relied upon by the petitioners did not involve fictitious securities, and have no bearing on this case.

3. Provisions of SIPA and a long line of cases construing it establish that a principal goal of the statute is to protect customers against the consequences of the financial failure of broker-dealers, and not to protect them from a broker's fraud. Here too, the cases relied upon by the petitioners are inapposite and create no conflict with the decision at hand.

4. Petitioners raise no important question warranting review. The issues are significant only to the parties involved, and have no importance beyond the narrow confines of SIPA cases.

ARGUMENT

The instant contested matter was brought within the context of a SIPA proceeding. Because an understanding of the

nature of the proceeding is significant to a proper resolution of the petition, the history of SIPA, as well as its purposes and relevant provisions, are examined below.

Nature of a SIPA Proceeding: Its History and Purposes

Prior to 1938, customers of a bankrupt stockbroker were considered as general creditors if they could not reclaim cash or securities which they could trace into the broker's possession. *Duel v. Hollins*, 241 U.S. 523, 527-29 (1916). Because serious inequities could and did result from this method of reclaiming, Congress enacted section 60(e) of the Bankruptcy Act in 1938.

A. Section 60(e) of the Bankruptcy Act

Section 60(e) of the former Bankruptcy Act, 11 U.S.C. §96(e) (repealed 1979), permitted "cash customers," as defined therein, to reclaim fully paid securities which were "specifically identifiable" as their property. 11 U.S.C. §96(e)(4) (repealed 1979). Otherwise, customers' cash and securities (not "specifically identifiable") constituted a "single and separate fund" to be applied in satisfaction of customers' claims (other than for specifically identifiable property) on a *pro rata* basis, subject only to prior payment of certain administrative expenses. 11 U.S.C. §96(e)(2) (repealed 1979). As for the unpaid balance of their "net equities", customers shared with general creditors in the general estate. See 3 *Collier on Bankruptcy*, ¶¶60.71-60.76 (14th ed. 1977).

Because of the usually inadequate single and separate fund, section 60(e) did not prevent customer losses. Customer exposure mounted when the rate of stockbroker failures accelerated in the 1960s. Congress responded to the crisis by enacting SIPA. *SIPC v. Barbour*, 421 U.S. 412, 415 (1975).

B. SIPA and SIPA as Amended

With some adjustments, SIPA expressly continued the

substantive scheme of section 60(e). Customers were still entitled to the return of their "specifically identifiable property." §78fff(c)(2)(C) (1970). SIPA also continued the single and separate fund to satisfy net equity claims of customers. §78fff(c)(2)(A) and (B) (1970). The major impact of SIPA on customer recoveries was to reduce losses by providing a limited back-up through SIPC funds. In essence, SIPA improved "collectability" while adhering to the section 60(e) philosophy of according customers limited preferential rights based on their actual securities and cash positions entrusted to the broker.

In 1978, SIPA was amended to provide greater flexibility to SIPC in satisfying customer claims in an expeditious fashion.[4] The essential elements of a SIPA proceeding remained unchanged.

C. SIPC and Its Funds

SIPC is a non-profit corporation whose members include most interstate broker-dealers. Membership in SIPC is automatic upon registration as a broker or dealer with the Securities and Exchange Commission ("SEC") under 15 U.S.C. section 78o(b). SIPA §78ccc(a)(2)(A).

SIPA requires SIPC to establish a fund via assessments upon its members. §78ddd(a)(1). If SIPC's funds should become inadequate, SIPA authorizes a borrowing against the U.S. Treasury of up to one billion dollars. §78ddd(f) - (h). These resources are available for the satisfaction of customer claims within certain limits.

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[4] SIPA has been amended by Pub. L. No. 94-29, 89 Stat. 163 (1975); Pub. L. No. 95-283, 92 Stat. 249 (1978); Pub. L. No. 95-598, 92 Stat. 2674 (1978); Pub. L. No. 96-433, 94 Stat. 1855 (1980); Pub. L. No. 97-258, 96 Stat. 1067 (1982); Pub. L. No. 97-303, 96 Stat. 1410 (1982); and Pub. L. No. 100-181, 101 Stat. 1265 (1987).

D. Use of SIPC Funds to Satisfy Customer Claims

SIPA requires the distribution of "a quasi-public fund." *SEC v. Packer, Wilbur & Co.*, 498 F.2d 978, 980 (2d Cir. 1974). Under section 78fff-3(a), SIPC is authorized to advance to the trustee, in order to satisfy net equity claims of customers, up to $500,000 per customer of which no more than $100,000 may be used to satisfy a claim which is for cash rather than for securities. Regardless of the assets of the failed firm, each customer eligible for protection is assured of satisfaction within the SIPA limits. However, SIPA does not attempt to make all customers whole and SIPC's role is carefully delineated. It contemplates that customers' claims will be satisfied to the maximum extent possible from the assets of the defunct member firm. Thus, customers share on a *pro rata* basis in any fund of customer property and any general estate, §78fff-2(c)(1), with SIPC funds supplementing those assets within the limits and in the manner provided by the statute. To the extent of its advances, SIPC is subrogated to the claims of such customers. SIPA §78fff-3(a). *See SIPC v. Associated Underwriters, Inc.*, 423 F.Supp. 168, 170-173 (D. Utah 1975).

E. Bankruptcy Nature of a SIPA Proceeding

Notwithstanding the special protection afforded customers, a proceeding under SIPA essentially is a bankruptcy liquidation. See, *e.g., SIPC v. Ambassador Church Finance/Development Group, Inc.*, 788 F.2d 1208, 1210 (6th Cir.), *cert. den. sub nom., Pine Street Baptist Church v. SIPC*, 479 U.S. 850 (1986); *SEC v. Albert & Maguire Sec. Co.*, 560 F.2d 569, 572 (3d Cir. 1977); *Exchange National Bank v. Wyatt*, 517 F.2d 453, 457-459 (2d Cir. 1975); *SEC v. Aberdeen Securities Co.*, 480 F.2d 1121, 1123 (3d Cir.), *cert. den. sub nom., Seligsohn v. SEC*, 414 U.S. 1111 (1973). Indeed, one of the stated goals of the proceeding is "to liquidate the business of the debtor." SIPA §78fff(a)(4). The application to commence a proceeding is filed by SIPC in federal district court, §78eee(a)(3), which puts into effect the Bankruptcy Code's automatic stay.

11 U.S.C. §362(a). If the court grants the application, it appoints a trustee to administer the liquidation and removes the proceeding to the bankruptcy court for that district. §§78eee(b)(3) and (b)(4). To the extent consistent with SIPA, the SIPA proceeding is to "be conducted in accordance with, and as though it were being conducted under chapters 1, 3, and 5 and subchapters I and II of chapter 7" of the Bankruptcy Code. §78fff(b).

Because the SIPA proceeding effectively is a bankruptcy proceeding, it looks not only to the disposition of claims of customers, but also to the claims of general creditors. *In the Matter of Lewellyn*, 26 B.R. 246, 253 (Bankr. S.D. Iowa 1982); *Gold v. Hyman*, [1974-75 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶95,043 at p. 97,657 (S.D.N.Y. 1975). To enable the trustee to carry out his responsibilities not only to customers but to the entire bankruptcy estate and all of its creditors, the trustee is given the same powers and title with respect to the debtor and its property as a trustee in bankruptcy, as well as powers that will enable him to perform the special functions of a SIPA liquidation. §78fff-1(a). *See SIPC v. Christian-Paine & Co.*, 755 F.2d 359, 361 (3d Cir. 1985). Estate property collected by the trustee is distributed as specified in section 726 of the Bankruptcy Code. §78fff(e).

A SIPA proceeding has elements that differ from those of a bankruptcy proceeding. For example, in the SIPA liquidation, the trustees and their counsel, while appointed by the district courts, are selected by SIPC. §78eee(b)(3). The trustee is responsible for mailing notices to customers and other creditors. §78fff-2(a)(1). Customers "need not file a formal proof of claim" but must file a "written statement of claim," which is submitted to the trustee instead of the court. §78fff-2(a)(2).

F. The Burden of Proof

"Customer" status in a SIPA proceeding is a preferred status which gives the customers priority over other creditors in

the distribution of certain assets marshalled by the trustee. *SIPC v. I.E.S. Management*, 612 F.Supp. 1172, 1177 (D.N.J. 1985), *affirmed w/o opinion*, 791 F.2d 921 (3d Cir. 1986) ("customers" under SIPA receive preferential treatment by being satisfied ahead of general creditors); *In re Hanover Square Securities*, 55 B.R. 235, 237 (Bankr. S.D.N.Y. 1985) ("[a]ffording customer status confers preferential treatment"); *In re Government Securities Corp.*, 90 B.R. 539, 540 (Bankr. S.D. Fla. 1988) ("customers" under SIPA have "preferred status"). SIPA derives from subsection "e" of section 60 of the Bankruptcy Act (repealed 1979) which was entitled "Preferred Creditors." Because of the availability of SIPC funds, one who qualifies as a customer in a SIPA proceeding may be paid, within the limits of protection, even when the debtor's estate has no assets. §§78fff-2(b)(1) and 78fff-3(a).

In ordinary bankruptcy, claimants seeking a preferred status bear the burden of showing that they are within the class of eligible persons and that their transactions are protected under the Act. *In re Chitwood*, 3 Bankr. Ct. Dec. 1033, 1034 (Bankr. S.D. Ala. 1977). *Accord, In re O.P.M. Leasing Services, Inc.*, 60 B.R. 679, 680 (Bankr. S.D.N.Y. 1986). The same rule applies to a SIPA case. In a SIPA proceeding, the burden of proof rests with the party seeking customer status. See §78fff-2(b). See also *In re Brentwood Securities, Inc.*, 925 F.2d 325, 328 (9th Cir. 1991); *In re Oberweis Securities, Inc.*, [1992 Decisions] Fed. Sec. L. Rep. Transfer Binder (CCH) ¶96,890 at 93,650 -- 93,651 (Bankr. N.D. Ill. 1992); *In re Waddell Jenmar Securities, Inc.*, 126 B.R. 935, 942 (Bankr. E.D.N.C. 1991).

I. THE SIXTH CIRCUIT'S CONCLUSION THAT THE TRUST, AND NOT THE INDIVIDUAL PARTICIPANTS, IS THE "CUSTOMER," IS CONSISTENT WITH THE RELEVANT LAW.

A. *Morgan Kennedy*

The conclusion of the Sixth Circuit that the Individual

Participants were not "customers" comports fully with the applicable law, *Morgan, Kennedy* and SIPC Rule 104. In *Morgan Kennedy*, the Second Circuit considered whether employee-beneficiaries of a trust created under a profit-sharing plan were "customers" under SIPA. Noting that the emphasis in the legislative history of, and case law under, SIPA was on protection of customers as investors and purchaser/traders, the court concluded that the trust beneficiaries could not qualify as customers. 533 F.2d at 1317. Thus, the trust funds had been contributed by the employer; the trustees of the trust made the decision to entrust the funds to the debtor in that case; the beneficiaries were not traders or investors; the employees' interest was reflected only on the books of the pension plan, and not on those of the broker; the trust account was in the name of the trustees on the broker's records; no beneficiary could give buy or sell orders in the account; and the trustees had the exclusive power to remit funds to the broker, to invest, and to make trading decisions. Furthermore, none of the usual characteristics of a broker-customer relationship existed between the broker and the trust beneficiaries. *Id.* at 1318. In the court's view, the customer on whose behalf the broker acted was the trust itself. *Id.* at 1321.

The facts with respect to the 490 Fund are virtually identical to those in *Morgan Kennedy*. Uncontroverted evidence adduced at trial, including, in part, the trust agreement, established that 1) the trust funds invested with FOSC were contributed by the Employer; 2) title to the trust funds was solely in the trustees; and 3) the trustees had exclusive authority and discretion to manage and control fund assets. The Fund alone dealt with the broker and was the market participant. Thus, as Robert Frazier, the principal officer of the Fund's administrator as well as a consultant and attorney to the Fund, testified, the 490 Fund brokerage account was in its name. Only one account had been created. The individuals never received account statements from FOSC or its clearing broker. Indeed, they could not have, as their identities would not have been known to the broker. The 490 Fund alone could make trading

decisions. Individual participants had no such authority.[5]

The Fund's attempt to distinguish this case from *Morgan Kennedy* on the ground that it is a defined contribution plan is to no avail. Cert. Pet. at 17-21. Although the books of the 490 Fund ostensibly identified the Individual Participants' interests in Fund assets, *id.* at 18, the books of the broker-dealer did not. As far as the broker-dealer was concerned, the only investor-trader was the Fund. The participants, all of whom were unidentified to the broker, were mere beneficiaries who stood to profit or lose from the Fund's, and not their own, market involvement. The *Morgan Kennedy* decision continues to be the correct interpretation of SIPA, see 4 *Collier on Bankruptcy*, ¶745.02 at p. 745-4 (15th ed. 1994), and was fully applicable here.[6]

In re Waddell Jenmar Securities, Inc., 126 B.R. 935 (Bankr. E.D.N.C. 1991) ("*Waddell*"), relied upon by the petitioners, compels no different conclusion. As an initial matter, it should be noted that no appeal was taken from the bankruptcy court decision in *Waddell*. Therefore, the Fund's citation (Cert. Pet. at 19-20) showing affirmance by the Fourth Circuit is in error, and there is no conflict between circuit court decisions.[7] Furthermore, *Waddell* neither supports the

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[5] These circumstances alone point up the fact that the participants are not "customers" under SIPA section 78*lll*(2). Having established no account with, and purchased no securities through, the Debtor, the participants could have no "claim on account of securities received, acquired, or held by the debtor.... from or for the securities accounts of such person." SIPA §78*lll*(2). Moreover, because all monies came from the trust, the participants could not be customers by reason of having deposited cash with the Debtor. *Id.* See Cert. Pet. at 13.

[6] As recognized in *Morgan Kennedy* and in SIPC Rule 104, discussed below, trust beneficiaries receive no protection as customers. 533 F.2d at 1319-1320.

[7] 991 F.2d 792 (4th Cir. 1993) reflects the Fourth Circuit's affirmance of a district court decision in another proceeding within the *Waddell* case. That adversary proceeding involved litigation over a fidelity bond between SIPC as trustee and the insurer, the National Union Fire Insurance Co. of Pittsburgh, PA. *In re Waddell*

petitioners' position nor conflicts with *Morgan Kennedy*. Cert. Pet. at 20. In *Waddell*, the bankruptcy court concluded that certain trust fund participants were not "customers" because their monies, having been misappropriated, never were deposited with the broker so as to render the participants customers. In reaching that conclusion, the court opined that the participants were customers as to some transactions; however, those transactions were not the subject of the claims that had been filed. Although the court's pronouncement would appear to support the petitioners' position, in fact, it does not for at least several reasons. First, the statement is mere dictum having no bearing on the court's holding. Second, that the court elected not to decide the same issue as the one presented here, is clear from its discussion at a later point in the decision. There, it remarked:

> SIPC had argued that the [participants] were limited to one aggregate claim rather than each having individual claims. The issue would only be relevant if the aggregate allowed claims exceeded the SIPC claim limit. That is not the case here, and that issue need not be addressed.

126 B.R. at 944, n.9. Finally, even assuming, *arguendo*, that *Waddell* had decided that trust participants could be "customers," the facts of the case are sufficiently distinguishable as to make it inapplicable. Thus, in *Waddell*, each employee would direct the investment of his portion of the plan fund. Each would receive a personal account summary from Guilford Waddell who was president both of the debtor broker-dealer and of the administrator of the plan. Each would meet with him to discuss investment strategy and each would give him investment instructions. In contrast, no evidence was introduced below showing direct trading by the participants in this case.

Jenmar Securities, Inc. (SIPC v. National Union Fire Ins. of Pittsburgh, PA), 25 Fed. Rules Serv. 3d 713 (4th Cir. 1993).

B. SIPC Rule 104

The fact that the Sixth Circuit's decision is consistent with applicable law is borne out not only by *Morgan Kennedy*, but by SIPC Rule 104(b), 17 C.F.R. §300.104(b). Under SIPA section 78fff-3(a), within specified limits, SIPC advances funds "for each customer." However, a customer holding accounts in different capacities is "deemed to be a different customer in each capacity." §78fff-3(a)(2). The Series 100 Rules define when accounts are held in separate capacities. Rule 104(b) thereof provides as follows:

> A qualifying trust account held with a member shall be deemed held by a separate customer of the member, distinct from the trustee, the testator or his estate, the settlor, or any beneficiary of the trust.

Thus, under SIPC rule 104(b), which is law,[8] as under the Sixth Circuit's decision, the trust alone is the customer.

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[8] The Series 100 Rules were adopted by SIPC pursuant to SIPA section 78ccc(b)(4). Once approved by the SEC, SIPC rules are to "be given force and effect as if promulgated by the Commission." SIPA §78ccc(e)(2)(D). See also SIPA §78ccc(e)(2)(A). Inasmuch as Congress has delegated to SIPC the power to adopt rules defining terms used in SIPA, the Series 100 Rules are legislative in nature and have the full force and effect of law. As stated in the legislative history of SIPA section 78ccc:

> New procedures appropriate to legislative, rather than interpretive rules are provided since SIPC's rules will have the force and effect of law.

H. R. Rep. No. 746, 95th Cong., 1st Sess. 25 (1977). See *Chrysler Corp. v. Brown*, 441 U.S. 281, 301-303 (1979); *United States v. Mersky*, 361 U.S. 431, 437-438 (1960); *Baker v. Otis Elevator Co.*, 609 F.2d 686, 691 (3d Cir. 1979) ("[v]alid legislative rules have about the same effect as valid statutes; they are binding on courts").

II. THE DECISION THAT THE CLAIM WAS FOR CASH, AND NOT SECURITIES, IS CONSISTENT WITH THE RELEVANT LAW.

A. The Applicable Case Law

The 490 Fund also errs in contending that the decision that its claim was for cash conflicts with applicable law. To be sure, the deposit of the Fund's cash with the broker for the purpose of purchasing CDs, which are securities under SIPA section 78*lll*(14), made it a customer under the statute, but it does not mean that, as a customer, the Fund was owed CDs. Under SIPA section 78*lll*(2), "customer" includes "any person who has deposited cash with the debtor for the purpose of purchasing securities." However, the mere deposit of cash in order to buy securities does not make the purchase an accomplished fact. Rather, in order to determine whether the customer is owed cash or securities, it is necessary to examine the customer's transactions, as shown on the debtor's books and records or as "otherwise established to the satisfaction of the trustee." SIPA §78fff-2(b). Furthermore, because claims are measured under SIPA as of the "filing date," *id.* and SIPA §78*lll*(7) and 78*lll*(11), what is owed to the customer must be computed as of that date. See *In re Bell & Beckwith (Murry v. McGraw)*, 821 F.2d 333, 335 (6th Cir. 1987); *SEC v. Aberdeen Securities Co.*, 480 F.2d 1121, 1123-24 (3d Cir.), *cert. den. sub nom., Seligsohn v. SEC*, 414 U.S. 1111 (1973); *Matter of Bevill, Bresler & Schulman, Inc.*, 83 B.R. 880, 892 (D.N.J. 1988).

Beyond dispute, the CDs did not exist. The Fund offered no proof that any had been bought. Indeed, it could not have because, as the Trustee's investigation revealed, the Fund's money, like that of other customers, had not been used to buy securities for customers, but had been converted by Thomas Gilmartin, a principal of the Debtor, to his own use. In light of the evidence, the Sixth Circuit correctly concluded that the Fund had a claim for cash, a result clearly consistent with the

pertinent case law as discussed below.

In *SEC v. Aberdeen Securities Co., supra*, the claimant had purchased shares of a prospective new issue. The shares were paid for, and the trade confirmed to the claimant by its broker, Aberdeen Securities Co. ("Aberdeen"). Although Aberdeen remitted the funds to the broker-dealer underwriting the offer, no certificates were received. Instead, before the stock could be issued, both the issuer and the underwriter went into bankruptcy. A SIPA liquidation proceeding subsequently was initiated for Aberdeen, and the claimant filed a claim in that proceeding. Because the security had no value, the Aberdeen trustee determined that no payment could be made to the claimant, a conclusion that was affirmed by the lower court. On appeal, the Third Circuit disagreed, commenting as follows:

> *[T]he facts demonstrate that since this particular stock was not in existence, the purchase never could be made. The Raizes, therefore, do not have a claim for the stock itself.*
>
> * * *
>
> Thus, if under local law, or by virtue of regulations under which it operated, the debtor was obligated to refund the $500 to the Raizes because of inability to deliver the Boatland stock, then there would be a claim for cash properly included in the term "net equity." [Emphasis added].

480 F.2d at 1127. Similarly, in *In re Brentwood Securities, Inc.*, 925 F.2d 325, 328, 329 (9th Cir. 1991), the court concluded that the debtor broker-dealer did not hold shares of a security for a claimant where the shares had not come into existence.

B. The Series 500 Rules

Contrary to the petitioners' contention, the SIPC Series 500

Rules, 17 C.F.R. §300.500 *et seq.*,[9] create no conflict. Although the 490 Fund contends that it introduced evidence establishing the existence of securities, in fact, the only proof offered suggested that the Fund might have *believed* at one time that CDs existed. Relying upon the Series 500 Rules, the petitioners maintain that because they expected the broker to be holding securities for them, their claim must be for securities. The Series 500 Rules do not apply, and in any event, any expectation by the Fund that CDs had been bought for it was unfounded.

The Series 500 Rules relate to whether a customer has a claim for cash or for securities; however, they have no bearing on the situation where a security does not exist. The circumstance intended to be reached by the Rules is illustrated by a number of cases, the most recent of which, before the adoption of the Rules, was *In re Bell & Beckwith (Murray v. McGraw)*, 821 F.2d 333 (6th Cir. 1987) ("*Murray*"). See 53 Fed. Reg. at 10368, n. 1 (Mar. 31, 1988). On February 4, 1983, the Murrays instructed their broker to sell certain stock. The sale was effectuated and a statement confirming the sale was issued to them. The statement showed a "trade date" of February 4, but a "settlement date" of February 11.[10] One day after the trade date, and before the settlement date, the broker failed. The Murrays argued that notwithstanding the sale, their claim was for securities. In the intervening period between the placement of the firm in SIPA liquidation and the filing of the Murrays' claim, the stock had become more valuable. *Murray*,

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[9] The petitioners mistakenly refer to the SIPC Series 500 Rules, as rules of the SEC. Cert. Pet. at 21, 23. Although proposed SIPC rules are subject to approval by the SEC, and are given force and effect as though promulgated by the SEC, they nevertheless are promulgated by SIPC. SIPA §78ccc(e)(2).

[10] The trade date is the date on which a trade occurs. The settlement date is the date cash and securities actually change hands. New York Institute of Finance, *Introduction to Brokerage Operations Dept. Procedures* (2d ed. 1988) at 229, 233.

821 F.2d at 334-335. The court held the claim to be for cash. *Id.* at 339-340.

The issue presented in *Murray* is typical of the situation intended to be reached by the Series 500 Rules, and indeed triggered the adoption of the rules. 53 Fed. Reg. at 10368, n.1. A review of the other cases giving rise to the Rules reveals that in no instance was the security at issue fictitious. *Id.* To be sure, Rule 502(a)(1), 17 C.F.R. §300.502(a)(1), specifies that a customer has a securities claim where, as in *Murray*, the customer has been sent "written confirmation ... that the securities in question have been purchased for or sold to the customer's account." Although in the instant case, documents which purported to be confirmations were sent to the 490 Fund, not only were the statements fictitious but more importantly, there never were any "securities" to purchase. Hence, clearly, the Series 500 Rules cannot apply.

In re June S. Jones Co., 52 B.R. 810 (Bankr. D. Ore. 1985) ("*Jones*"), cited by the petitioners, does not suggest otherwise. Cert. Pet. at 24-25. The MSM stock in that case was an actual security. Furthermore, it is noteworthy that in *Jones*, the bankruptcy court observed that the *Aberdeen* case, discussed above, was distinguishable factually in that it involved, unlike *Jones*, a situation where the security could not have been purchased because it did not exist. 52 B.R. at 813. In view of the Series 500 Rules which provide, in relevant part, that a customer has a claim for a security if he has received written confirmation of a purchase, the *Jones* court correctly concluded that a customer may be owed securities even if the securities were not purchased prior to the filing date. 52 B.R. at 813. However, contrary to the petitioners' contention, as recognized in *Jones* in distinguishing *Aberdeen*, that rule does not apply where the security does not exist.[11]

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[11] Similarly, *In re C. J. Wright & Co.*, 162 B.R. 597 (Bankr. M. D. Fla. 1993), an unauthorized trading case, is inapplicable. Cert. Pet. at 27.

C. The Account Statements

In any event, reliance by the Fund upon the confirmations would have been unreasonable inasmuch as a critical piece of information was missing from them. A CD evidences an obligation of a bank or savings association to repay the principal amount of the certificate, with interest, at maturity. Allan H. Pessin, *The Illustrated Encyclopedia of the Securities Industry* 62 (1988). The physical certificate that is issued contains the names of the issuing bank or savings association and the purchaser, the principal amount deposited with the financial institution, the rate of interest payable at maturity, and the term of the CD. See Marcia Stigum, *The Money Market* 526 (1983). The putative confirmation statements issued to the 490 Fund confirmed the purchases of CDs, yet, nowhere in the statements was the name of the issuing bank or savings association revealed. Absent identification of the issuer, the Trustee would not know which CDs to attempt to purchase on the open market for delivery to the claimants. Nor could he ascertain a filing date market value in the event the security was not available in a fair and orderly market. See *supra*, n.3 and SIPA §78fff-2(b). Yet, a factor that is crucial to the market value of a CD is the financial condition of the issuer. See Marcia Stigum, *The Money Market* 36 (1983) ("Yields on CDs exceed those on bills of similar maturities by varying spreads. One reason for the higher yield is that buying a bank CD exposes the investor to some credit risk -- would he be paid off if the issuing bank failed?"). If the issuer fails financially, its CDs ostensibly have a value of zero. To ascribe any other value to the instant fictitious CDs, one has to assume that the issuer is a publicly or privately insured institution, that the CDs are covered by the insurance, and that the insurance fund itself is or was solvent.

It bears mention that it is perhaps not surprising that the Fund failed to question the completeness and accuracy of the statements. Testimony elicited at trial established that Mr. Frazier, as a principal officer of the 490 Fund's administrator

with oversight of the Fund's investments, and as a consultant to it, was engaged in various business endeavors of his own with Mr. Gilmartin, the FOSC principal, which undoubtedly colored his objectivity in overseeing the Fund's investments. Not until a new administrator was retained by the 490 Fund were irregularities in the statements questioned. Cert. Pet. at 13. The Sixth Circuit's decision comports with applicable law.

III. THE SIXTH CIRCUIT'S DECISION FOLLOWS WELL-ESTABLISHED LAW THAT SIPA DOES NOT PROTECT INVESTORS AGAINST THEIR BROKER'S FRAUD.

Petitioners' contention that SIPA protects against damages that result from a broker's fraud overlooks the nature of the SIPA protection and a long line of cases that recognize that no such protection is afforded under the Act.

Preliminarily, the petitioners mistakenly argue that the Court of Appeals denied them the protection afforded to customers with "securities" claims because of their broker's fraud. Cert. Pet. at 26. In actuality, that the 490 Fund was misled was irrelevant to the determination of its claim. Rather, the claim of the Fund was allowed in full, but it was allowed as a "cash" claim because no purchase of genuine securities was confirmed to them or made for them.

Nonetheless, the petitioners assert that it comports with the purposes of SIPA for customers to be protected for their damages resulting from the broker's fraud. Cert. Pet. at 26-29. In fact, it does not. Although a central goal of SIPA is investor protection, the protection is a carefully crafted and limited one. As evident from the language of the "customer" definition (SIPA §78*lll*(2)), the intent of Congress was to protect persons who had entrusted cash or securities to their brokers for the

purposes of trading and investing.[12] Protecting customers' cash and securities and thereby instilling confidence in the securities markets was perceived as essential to protection of the markets. *Hearings on H. R. 13308 Before the House Subcomm. on Commerce and Finance of the Comm. on Interstate and Foreign Commerce*, 91st Cong., 2d Sess. ("1970 H. Hearings") at 149-150 (June 4, 1970) (statement of Mr. Budge). *See also id.* at 345 (July 9, 1970) (statement of Bruce K. MacLaury, Deputy Undersecretary of the Treasury Dept.); and *Hearings on S. 2348 Before the Senate Subcomm. on Securities of the Comm. on Banking and Currency*, 91st Cong., 2d Sess. ("1970 S. Hearings") at 4 (April 16, 1970) (testimony of Sen. Muskie). At the same time, it was emphasized that the protection under SIPA had to be limited. A SIPA proceeding could not be turned into a "bailout operation." 1970 H. Hearings at 369 (July 15, 1970) (statement of Mr. Budge). *See* 1970 S. Hearings at 16 (April 16, 1970) (remarks of Mr. Budge), and 279 (July 16, 1970) (remarks of Philip A. Loomis, General Counsel of the SEC).

In furtherance of the notion that the proceeding is not a "bailout operation" in the sense of satisfying every investor loss, the asserted loss must be a direct result of the broker's insolvency, in order to be covered under SIPA. Thus, under SIPA section 78*lll*(11), a customer's "net equity," or the measure of what he is owed in cash and/or securities, is valued as of the filing date. The statute thereby emphasizes that the legislative intent is to maintain the *status quo* of matters generally as they stand on the date SIPC seeks to have the firm placed in liquidation. SIPA §78*lll*(7).

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[12] *SIPC v. Executive Securities Corp.*, 556 F.2d 98, 99 (2d Cir. 1977); *SEC v. F.O. Baroff Co.*, 497 F.2d 280, 282-283 (2d Cir. 1974); *SIPC v. Associated Underwriters, Inc.*, 423 F.Supp. 168, 171 (D. Utah 1975).

The case law consistently has reflected that intent.[13] As stated in *In re, MV Securities, Inc.*, 48 B.R. 156, 160 (Bankr. S.D.N.Y. 1985):

> The cases hold that the "SIPA does not protect customer claims based on fraud or breach of contract." *SEC v. Howard Lawrence & Co., Inc.*, 1 B.C.D. 577, 579 (Bkrtcy. S.D.N.Y. 1975). "[I]t seems plain that SIPA's primary intent and policy are to protect customers who have cash and securities being held for them by a broker dealer, *rather than to serve as a vehicle for the litigation of claims of fraud* or violations of Rule 10b-5****" *SEC v. North American Planning Corporation*, 72 Civ. 3158 (Bkrtcy. S.D.N.Y. 1974) (Unpublished Opinion at 4). "To require the Trustee to use SIPC funds to pay damages for a breach of contract claim against the debtor would not serve the congressional purpose of avoiding the domino effect inherent in unfulfilled open contractual commitments and would only serve to give a windfall to those who are general creditors based upon breach of contract claims." *SEC v. Kelly, Andrews & Bradley, Inc.*, 385 F.Supp. 948, 949, 952-3 (D.C. S.D.N.Y. 1974). Although the emphasis on the customer as investor and purchaser/trader has been a consistent theme in cases in the Second Circuit, the court has nevertheless approved a narrow interpretation of the "customer" definition in

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[13] *SIPC v. Vigman*, 803 F.2d 1513 (9th Cir. 1986), *appeal after remand*, 908 F.2d 1461 (9th Cir. 1990), *aff'd in part and rev'd in part*, ____ U.S. ____, 112 S. Ct. 1311 (1992), ("*Vigman*"), and *Matter of Investors Sec. Corp.*, 6 B.R. 420 (W.D. Pa. 1980), are no exceptions. See Cert. Pet. at 28. No customer status question was presented in *Vigman* which involved SIPC's standing to sue for securities fraud. Similarly, the decision is *Matter of Investors Sec. Corp.*, which was modified on appeal, *In the Matter of Investors Security Corp. (Ravis v. Day)*, Civil Action No. 80-1032 (W.D. Pa. 1981), presented the question of whether a salesman of a broker who also operated independently his own business constituted an agent of the broker so as to render the investor a "customer."

SIPA. [citations omitted and emphasis added].

See *SEC v. Kenneth Bove & Co.*, 378 F.Supp. 697, 700 (S.D.N.Y. 1974); *Matter of Oberweis Securities, Inc.*, 135 B.R. 842, 846 (Bankr. N. D. Ill. 1991); *In re Bell & Beckwith*, 124 B.R. 35, 36 (Bankr. N. D. Ohio 1990); *In re Government Securities Corp.*, 90 B.R. 539, 540-541 (Bankr. S. D. Fla. 1988); *Matter of M. S. Wien & Co.*, 54 B. R. 18, 19-20 (Bankr. D.N.J. 1985). The decision of the Sixth Circuit is in accord.

The petition presents no issue worthy of review. It identifies no conflict between court decisions and does not present the kind of important question justifying review. It is significant only to the parties involved, and has no implications other than in the narrow body of SIPA cases. In the final analysis, it is no more than an attempt to obtain protection where none exists. As the Ninth Circuit stated:

> Every market has its dreamers and its crooks. Occasionally, they are one and the same. The SIPA protects investors when a broker holding their assets becomes insolvent. It does not comprehensively protect investors from the risk that some deals will go bad or that some securities issuers will behave dishonestly.

In re Brentwood Securities, Inc., 925 F.2d 325, 330 (9th Cir. 1991).

CONCLUSION

For the foregoing reasons, the petition for a writ of certiorari should be denied.

Respectfully submitted,

THOMAS R. LUCCHESI
HILARY W. RULE
BAKER & HOSTETLER
3200 National City Center
Cleveland, Ohio 44114
Telephone: (216) 621-0200
Attorneys for William Appleton, Trustee

MICHAEL E. DON
Acting General Counsel
SECURITIES INVESTOR PROTECTION CORPORATION
805 Fifteenth Street, N.W.
Suite 800
Washington, D.C. 20005-2207
Telephone: (202) 371-8300

OF COUNSEL:

JOSEPHINE WANG
Associate General Counsel

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